MISCELLANEOUS TAX BILLS

HEARING

BEFORE THE

SUBCOMMITTEE ON
SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

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MISCELLANEOUS TAX BILLS

WEDNESDAY, OCTOBER 3, 1984

House of Representatives,
Committee on Ways and Means,
Subcommittee on Select Revenue Measures,
Washington, DC.

The subcommittee met at 10:08 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Fortney H. (Pete) Stark (chairman of the subcommittee) presiding.

Chairman Stark. The Subcommittee on Select Revenue Measures will begin.

The subcommittee meets today to consider a number of miscellaneous bills that cover a wide range of areas. Several of the provisions raise revenues; some of them lose revenues; others are essentially technical and have little in the way of revenue impact.

The subcommittee is not under any official pay-as-you-go rule. It has long been our concern that the subcommittee balance its legislation between revenue losers and gainers. Lest we in some manner add to the deficit.

These hearings are essentially informational in nature since we don't intend to mark these bills up in this session. The bills do, however, represent matters of concern to various members of the committee, and indeed to the Treasury, and, in many cases, they warrant further study.

I ask unanimous consent that the press releases announcing today's hearing be made part of the record.

[The press releases follow:]

[Press release No. 16, Friday, Sept. 21, 1984]

Hon. Fortney H. (Pete) Stark (D., Calif.), Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, Announces a Public Hearing on Miscellaneous Tax Bills To Be Held on October 3, 1984

The Honorable Fortney H. (Pete) Stark (D., Calif.), Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, announces a public hearing on miscellaneous tax bills to be held on Wednesday, October 3, 1984, in the Committee's main hearing room, 1100 Longworth House Office Building, at 10:00 a.m. Testimony will be taken from the Treasury Department and interested members of the public.

Testimony is invited on the following bills:

H.R. 700—(Messrs. Stark, Hance, Dorgan, Frenzel, et al), To define the circumstances under which construction workers may deduct travel and transportation expenses in computing their taxable incomes for purposes of the Federal income tax.

H.R. 907—(Messrs. Vander Jagt, Conable, Duncan, Heftel of Hawaii, Jenkins, and Jones of Oklahoma), To amend section 119 of the Internal Revenue Code of 1954 to provide that meals furnished by an employer to an employee may be considered furnished for the convenience of the employer if the meals are furnished on the business premises of the employer generally, except under certain conditions whereby meals may be furnished off the business premise of the employer.

H.R. 1343—(Mr. Lowry of Washington), To amend section 593 of the Internal Revenue Code of 1954 to provide greater equity in the treatment of stock savings banks in relation to the bad debt reserve deduction that is available to mutual savings banks.

H.R. 1773—(Messrs. Duncan of Tennessee, Guarini, Vander Jagt, Gephardt, Matsui, Flippo, Jacobs, et al), To amend the Internal Revenue Code of 1954 with respect to the unrelated business taxable income of certain nonprofit charitable organizations.

H.R. 2129—(Messrs. Matsui, Stark, and Thomas of California), To amend the Internal Revenue Code of 1954 to provide an alternative method of allocation of property taxes for cooperative housing corporations.

H.R. 2256—(Messrs. Matsui, Mineta, and Zschau), To amend the Internal Revenue Code of 1954 to provide that income otherwise eligible to be taken into account in computing the section 936 credit shall not be ineligible merely by reason of being received in the United States.

H.R. 2686—(Messrs. Guarini, Stark and Frenzel), To amend the Internal Revenue Code of 1954 with respect to the treatment of business development companies.

H.R. 3388—(Messrs. Matsui, Thomas of California, and Mr. Fazio), To provide that the provisions of section 252 of the Economic Recovery Tax Act of 1981 (relating to transfers of property to employees subject to certain restrictions) shall apply to certain transfers occurring during 1973.

H.R. 3528—(Mrs. Kennelly), To allow a deduction for certain freight forwarder operating authorities.

H.R. 4167—(Messrs. Jenkins, Fowler, Gephardt, Mrs. Kennelly, Messrs. Matsui, Flippo, Anthony, Philip M. Crane, Archer, Moore, Duncan, Pickle, Hance, Vander Jagt, Dorgan, Campbell, Heftel of Hawaii, et al), To amend the Internal Revenue Code of 1954 to permit individual retirement accounts, qualified retirement trusts and certain educational organizations to invest in working interests in oil and gas properties without incurring unrelated business taxable income. Similar bills: H.R. 821 and H.R. 3820.

H.R. 4507—(Messrs. Foley, Rangel, Stark, Mrs. Kennelly, Messrs. Boland, and Schulze), To amend the Internal Revenue Code of 1954 to allow the investment credit with respect to taxable business conducted by certain religious communities without incurring unrelated business taxable income.

H.R. 4779—(Messrs. Thomas of California, Lagomarsino, Pashayan, and McCandless), To amend the Internal Revenue Code of 1954 to provide that the windfall profit tax shall not apply to an amount of crude oil equal to the amount of residual fuel oil used in tertiary recovery processes. Similar bill: H.R. 3099

H.R. 5022—(Mr. Stark), To amend the Internal Revenue Code of 1954 to provide that percentage depletion shall not be allowable for lease bonuses, advance royalties, or similar payments with respect to oil and gas properties.

H.R. 5199—(Mr. Stark), To amend the Internal Revenue Code of 1954 to clarify that the farm syndicate rules of section 278(b) apply in the case of inedible fruits and nuts.

Details for submission of requests to be heard:

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard by telephone no later than noon, Thursday, September 27, 1984, to Harriett Lawler [(202) 225-3627] to be followed by a formal written request to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth Building, Washington, D.C. 20515. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This procedure will afford more time for members to question witnesses. In order to expedite the hearing, witnesses may be grouped as panelists with strict time limitations for each panelist.

Requests to be heard, as well as prepared statements to be presented in person and statements for the printed record of the hearing, must contain the following information:

1. The name, full address, and capacity in which the witness will appear (as well as a telephone number where the or a designated representative may be reached);

2. A list of any clients or persons, or any organization for whom the witness appears; and

3. A topical outline or summary of comments and recommendations.

In order to assure the most productive use of the limited amount of time available to question witnesses, witnesses scheduled to appear before the Subcommittee must comply with the following rules:

1. All witnesses must submit 100 copies of their prepared statements to the full Committee office, 1102 Longworth House Office Building, not later than the close of business, Monday, October 1, 1984.

2. Witnesses should not read their written statements to the Subcommittee, but should instead limit their oral presentations to a summary of the points included in their statements.

3. Not more than five minutes will be allowed for the oral summary.

The Subcommittee wishes to emphasize that failure to comply with these requirements may result in the witness being denied the opportunity to testify in person or being deferred until all other testimony is heard.

Written Statements in lieu of personal appearance:

For those who wish to file written statements for the printed record of the hearing, six copies are required and may be submitted to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth Building, Washington, D.C. 20515, by close of business, Wednesday, October 17, 1984. An additional supply of statements for the printed record may be furnished for distribution to the press and public if supplied to the Committee office before the hearing begins.

[Press release No. 16—revised, Monday, Oct. 1, 1984]

HON. FORTNEY H. (PETE) STARK (D., CALIF.), CHAIRMAN, SUBCOMMITTEE ON SELECT REVENUE MEASURES, COMMITTEE ON WAYS AND MEANS, ANNOUNCES CHANGES IN THE PUBLIC HEARING ON MISCELLANEOUS TAX BILLS TO BE HELD ON OCTOBER 3, 1984

The Honorable Fortney H. (Pete) Stark (D., Calif.), Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, announces two changes to the hearing scheduled for Wednesday, October 3, 1984. The following bill was deleted from the list:

H.R. 2256—(Messrs. Matsui, Mineta, and Zschau), To amend the Internal Revenue Code of 1954 to provide that income otherwise eligible to be taken into account in computing the section 936 credit shall not be ineligible merely by reason of being received in the United States.

The following bill was added to the list:

H.R. 3284—(Messrs. Jenkins, Hance, Flippo, Heftel of Hawaii, Schulze, Guarini, and Mrs. Kennelly), To amend the Internal Revenue Code of 1954 to allow an amortization deduction for bus operating rights based on a 60-month period.

All other details of the hearing remain the same.

Chairman STARK. I want to emphasize to my colleagues and the members that because of the large number of witnesses, and because of another committee hearing later this afternoon—I think we are scheduled for some 34 witnesses here, so I want to remind everyone that in the announcement we insisted that, with the exception of the Treasury Department, who has to review all of the bills, we will put the full text of prepared remarks in the record but each witness will be held strictly to a 5-minute rule. They may read a 5-minute statement or summarize as they wish. And the Chair—and I am sure other witnesses—would appreciate it if the panels—some panels are somewhat larger than others—would attempt to follow the spirit of that. I don't intend to allow people to yield their 5 minutes to another member of the panel.

Questioning, similarly, by members of the committee, will be held to 5 minutes.

Having said that, our first witness is our distinguished colleague, my neighbor in California, Congressman Robert Matsui.

I have your statements—you, too, Bob—and you may proceed.

STATEMENT OF HON. ROBERT T. MATSUI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. MATSUI. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before you and the subcommittee.

With respect to H.R. 3388, there has been ample testimony on that particular issue over the last 4 years. And I will merely resubmit what I had submitted in prior testimony on that particular issue.

With respect to H.R. 2129, Mr. Chairman, I have submitted a written document dated October 3, and if the chairman or any other subcommittee members have any questions, I would be happy to answer them.

[The prepared statement follows:]

STATEMENT OF HON. ROBERT T. MATSUI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Chairman, I appreciate the opportunity to appear before the Subcommittee on Select Revenue Measures today in support of the bill H.R. 2129. I introduced this measure to alleviate specific and unintended effects of federal tax law that have adverse consequences for numerous taxpayers.

With respect to H.R. 2129, it should be noted that federal tax law provides that the property tax deduction allocable to a resident of a co-op must be in proportion to each resident's stockholding interest in the corporation that owns the building.

Proposition 13 has created unique tax problems in California as this measure freezes tax assessments until a unit is sold and then requires the new owner to pay the full amount of any increased assessments. Federal law requires however, that any increased assessments be allocated among and subject to deduction by all shareholders, even those shareholder-residents whose assessments on their units did not increase. Therefore, the allowable deduction does not reflect the actual tax liability incurred by each resident.

H.R. 2129 provides a special rule that if a state law requires that the property taxes be allocated other than on the basis of shareholding interest of each resident, the co-op residents are entitled to deduct only the amount of taxes actually paid.

A similar provision was contained in the Senate version of the Tax Reform act of 1984 but was not adopted by the Conference Committee because there were objections to other co-op sections with no relation to this provision.

Given the press of our legislative schedule, I hope that my colleagues on the Subcommittee might give this measure their favorable consideration.

Thank you.

Chairman STARK. Thank you very much, Mr. Matsui.

Mr. MATSUI. Thank you.

Chairman STARK. I am familiar with your legislation, and I appreciate your testimony.

Next we have the Honorable William Thomas of California, another member of our committee.

Bill, welcome to the committee. And you may proceed in your own fashion.

STATEMENT OF HON. WILLIAM M. THOMAS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. THOMAS. Thank you, Mr. Chairman.

I do want to thank you for this opportunity to testify on H.R. 4779, which is really the latest version of legislation I have been working on since 1981. Since I have been working on it for so long and have not had a hearing, I will not be nearly as short as Mr.

Matsui because it is a question I think that there has been a great deal of confusion over.

H.R. 4779 will correct what really is an unfortunate bias in the windfall profits tax, and it was a flaw in the windfall profits tax legislation which created a great deal of inefficient production and prevents a lot of attractive energy products from reaching consumers. What this bill will do will be to correct that problem.

I know you know that California is the Nation's fourth largest oil-producing State, and California's potential for even more production in the future is vast because the State has about 20 percent of the proven reserves in the United States. Part of the problem is that those proven reserves are in heavy oil, and the bulk of the heavy oil lies within my congressional district in California. The industry defines "heavy oil" as 20 degrees specific gravity or less—API, or less. The Government has defined it as 16 degrees or less.

When you get down to around 16 degrees, this oil doesn't flow; it just kind of oozes. And, in fact, in some areas it is so asphaltic that they mine it and haul it away in a truck. You can make a lot of useful products out of it, however, including gasoline. However, to get it to the surface, this heavy oil has to be heated, and you heat it primarily by pumping steam into the ground. And, obviously, to create steam you have to have some kind of energy to convert the water into steam. And therein lies the problem—because the windfall profits tax changed heavy production by inadvertently penalizing producers for using residual fuel oil, one of the least attractive refined products, the bottom of the crude oil barrel.

Before the tax was imposed, producers would ship off crude. There were a number of refiners that would do very minimal pulling off of light distillates; then send the residual back. And that would be burned in the boilers. And you had a very nice relationship, which was fairly efficient in using an entire barrel of crude. What happened was that the windfall profits tax imposed a tax on a barrel of crude leaving the property. And since residual had such a narrow margin of profit to it, what happened was that obviously producers now having a new economic reality simply burned the crude in the boilers instead of the residual fuel oil. So we lose those distillates that were otherwise pulled off.

Now, what that means is that—for example, the California Energy Commission indicated that as much as one-third of the net heavy oil production is used in thermal-enhanced oil recovery; that is, one-third of the heavy oil brought out of the ground is burned to bring more heavy oil out of the ground. In 1983, that meant about 100,000 barrels of crude were burned. Now, it is enough to lose the valuable petroleum products that would otherwise be obtained, but you have also emission problems because the crude burns dirtier than does residual fuel oil. As you know, our State has very stringent air pollution requirements, and it is simply a more expensive proposition.

In addition, if you will just examine some of the crude—for example, in my area, the Kern River crude is about 12½ specific gravity, and that means that we are losing about 1½ million gallons of useful distillates a day. If it is down in the Los Angeles basin, Wilmington crude, about 19½ specific gravity, or 20, that is about, in one day, half a million gallons of gasoline and napthas alone going up in smoke, if you will.

A report from the California Division of Oil and Gas, I think, really says it as clearly as we possibly can, and this is the thrust of the legislation entirely:

> The greatest potential for increasing the net production of heavy oil lies in reducing the amount of crude used to fuel steam generators. Residual fuel oil can be burned in steam generators in lieu of crude oil, resulting in a more energy-efficient operation. Resid yields more heat per barrel than crude oil, and the lighter hydrocarbons in crude oil would not be wasted on steam generation. Until the recent passage of the Windfall Profit Tax Act, burning resid was common practice. Now, however, the tax makes such practices economically prohibitive.

What I am trying to ( ) is to turn that around. The bill lets producers offset the windfall profits tax on a barrel of crude for each barrel of resid they use in enhanced recovery, and it would remove the bias created by that windfall tax.

I recognize there is no time left in this session for further work on this bill, but I do hope that we can understand that this is not an attempt to circumvent the windfall profits tax; what it is, in fact, is a legislative effort to correct a clear problem that was not foreseen when the windfall profits tax was passed.

Mr. Chairman, I thank you very much for this opportunity.

[The prepared statement follows:]

STATEMENT OF HON. WILLIAM M. THOMAS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Chairman, I want to thank you and the other members of the Subcommittee for this opportunity to testify on H.R. 4779. H.R. 4779 is the latest version of legislation on which I have worked since 1981. It will correct an unfortunate bias in the Windfall Profit Tax, a flaw that makes a great deal of oil production inefficient and prevents a lot of attractive energy products from reaching consumers.

H.R. 4779 will discourage wasteful use of our crude oil resources. I am sure members of the Subcommittee know that California is the nation's fourth largest oil producing state and of California's vast potential for future oil production; the State has nearly 20% of the proven reserves in the U.S. What many members may not know is that the bulk of California's reserves lie within my congressional district and that most of that crude oil requires special treatment if it is to be produced.

Much of California's oil resources are "heavy" crudes, which the industry defines as crude having a specific gravity of 20° or less and which the government has defined as having a specific gravity of 16° or less. Such crudes do not flow: they ooze if they move at all. They can be used to make gasoline or other useful products but they impose difficult burdens on producers. Heavy oil must be heated before production. This is achieved by pumping steam into the surrounding area. Steam generation in turn requires burning some other fuel to create heat.

The Windfall Profit Tax changed heavy production by inadvertently penalizing producers for using residual fuel oil, one of the least attractive refined products. Before the tax was imposed, producers bought residual fuel oil, powered steam generators with it, and then shipped crudes off to refineries where useful products like gasoline were extracted. Refineries sold resid back to the producers, creating a fairly efficient use of an entire barrel of crude. The Windfall Profit Tax stopped the practice because the tax is imposed when crude leaves a producing property. Adding the tax to residual fuel oil's cost makes it uneconomic for producers to continue using resid as a primary fuel source.

Instead, producers are burning a major part of their daily output in order to create needed steam. As the Windfall Profit Tax does not apply if producers use crude on the property, the oil industry has resorted to crude as a power source. In effect, Congress has forced the oil industry to make decisions on the basis of the tax code rather than economics.

The California Energy Commission indicates that as much as one-third of net heavy oil production is used in thermal enhanced oil recovery, and that as much as 9% of total state production disappears into this economic rathole. In 1983, that means almost 99,786 barrels of crude were burned each day. While it is difficult to estimate the loss of refined products with precision because of refineries' differing abilities to handle heavy crudes and because of variations in crudes themselves, we can develop a fairly good picture. Assuming the crude was 12.6° Kern River crude, for example, we lose about 1.4 million gallons of useful distillates each day; 19.4° Wilmington crude's use would cost us over half a million gallons of gasoline and naphthas alone, and as much as 2 million gallons of useful distillates in total.

A report developed for the California Division of Oil and Gas pretty much sums it up:

"The greatest potential for increasing the net production of heavy oil lies in reducing the amount of crude used to fuel steam generators. Residual fuel oil can be burned in steam generators in lieu of crude oil, resulting in a more energy-efficient operation. Resid yields more heat per barrel than crude oil, and the lighter hydrocarbons (e.g., gasoline, diesel, and naphtha) in crude oil would not be wasted on steam generation. Until the recent passage of the Windfall Profit Tax Act, burning resid was common practice. Now, however, the tax makes such practices economically prohibitive." [1]

H.R. 4779 is intended to end this waste. The bill lets producers offset the Windfall Profit Tax on a barrel of crude for each barrel of residual fuel oil they use in an enhanced recovery process. This simple legislation would end the tax's bias and promote more efficient use of our crude resources. The bill is designed to be revenue-neutral, as Treasury Department estimates show.

I recognize that there is no time left in this session for further work on this bill. I do hope Subcommittee members will work with me next year to secure passage of this legislation, however, and would welcome an opportunity to discuss it further with any of you who might be interested.

Chairman STARK. Thank you for your testimony.

Questions?

Mr. SCHULZE. I have no questions, Mr. Chairman.

Chairman STARK. Our next witness is the Honorable Mike Lowry, distinguished gentleman from Washington.

Without objection, your complete testimony will be made part of the record.

Welcome, and we are pleased to have you. You may summarize, or however you wish, do this in approximately 5 minutes that we have allotted to you.

STATEMENT OF HON. MIKE LOWRY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Mr. LOWRY. Thank you, Mr. Chairman, and members of the committee, for the opportunity to testify.

H.R. 1343 is intended to correct an inequity in the Tax Code between mutual savings banks and stock savings banks. As you know, Mr. Chairman, section 593 of the Tax Code provides a deduction for bad debt reserves for certain financial institutions, providing they have a certain amount of their assets in housing-related instruments. But there is an inequity between stock savings banks and mutual savings banks in that, to receive the full benefit of section 593, mutual savings banks must have 72 percent of their assets in housing-related instruments; but stock savings banks must have 82 percent of their assets in housing-related instruments.

This bill simply moves the stock savings banks to 72 percent of their assets in housing-related instruments, as is the case with mutual savings banks. That is what it does. I think we can see the need for that equity, and I would ask favorable consideration next year.

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[1] William F. Guerard, Jr., "Heavy Oil in California," California Division of Oil and Gas (Sacramento, 1982), p. 10.

[The prepared statement follows:]

STATEMENT OF HON. MIKE LOWRY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Mr. Chairman and Members of the Committee, thank you for giving me this opportunity to comment on H.R. 1343 which I introduced in February of 1983. I would like to commend the Committee for choosing to further consider the wide range of legislative proposals on today's agenda.

Put very simply, H.R. 1343 is intended to correct the arbitrary and inequitable distinction in the tax code between mutual savings banks and stock savings banks. A distinction which makes it more difficult for stock savings banks to qualify for favorable tax treatment under Section 593 of the tax code. It is my understanding that correcting this inequity would have negligible revenue impact.

For many years Section 593 has granted favorable tax treatment to mutual savings banks through a special deduction for bad debt reserve. Mutual savings banks can claim the full deduction only if at least 72% of their investments are in qualified housing related assets.

Both mutual and stock savings and loan associations may also use this deduction, but in contrast, they must meet an 82% qualified assets test. I would ask you to note that all S&L's must meet the same assets test regardless of the form of ownership. Historically, mutual savings banks were required to meet a lower qualified assets test than S&L's because savings banks were organized for different purposes and were granted different powers than S&L's.

Until quite recently, savings banks were limited to a mutual form of ownership. In 1980, however, Congress and some States, including Washington State, gave mutual savings banks the authority to convert to stock ownership. In recognition of this new form of ownership, the 1981 Economic Tax Recovery Act, modified section 593 to enable stock savings banks to qualify for the deduction for bad debt reserve provided to other thrifts.

Under the 1981 ERTA provision, stock savings banks must meet an 82% qualified assets test rather than the 72% assets test applied to mutual savings banks. H.R. 1343 would correct this discrepancy by treating both mutual and stock savings bank in an identical fashion—both would meet the same 72% test.

During debate on ERTA the Senate passed an amendment which would have accomplished the intent of H.R. 1343. Unfortunately this provision was modified in conference at the insistence of the Treasury Department.

This discrepancy between stock and mutual savings banks makes no sense. On an arbitrary basis, the ERTA provision provides that stock savings banks be treated like S&L's, not like other savings banks. Stock savings bank must meet the 82% test simply because they converted from mutual to stock ownership.

Conversion from mutual to stock ownership does not change the basic characteristics, purposes, or powers of the institution. A tougher assets test for stock savings banks simply serves as a disincentive to conversion. On the other hand, no disincentive was created for S&L's converting from mutual to stock ownership—since, despite different forms of ownership, both types of S&L associations meet identical qualified asset tests.

More importantly, however, this disincentive works at cross-purposes with present federal banking policy which has explicitly increased the opportunities for thrift conversion to stock ownership. The reason Congress and individual States have pursued this public policy is to enable the thrift industry to strengthen its capital base and net worth through stock conversions.

After several devastating years in which many thrifts have taken a terrible beating due to continued high interest rates, any action to strengthen these institutions is important. Failure to modify section 593 would frustrate the conversion option provided to mutual savings banks under recent changes in banking law.

As far as I know, the only objections to this bill have been raised by the Treasury Department. Their objections do not appear to challenge the logic of my bill—that a fundamental inequity exists between stock and mutual savings banks. Instead, Treasury Department "opposes piecemeal changes in Code section 593." Treasury contends that any modifications should be delayed until a comprehensive review of federal policy relating to thrifts is completed.

As a member of the House Banking Committee I am intimately familiar with the current controversy surrounding banking legislation. While I share the Treasury Department's enthusiasm for a comprehensive review of our nation's financial services industry—I have learned that no one can be quite sure when that process will be completed.

Specifically, I have had no quarrel with the Treasury Department's intention to conduct a review of section 593 due to changes in the asset powers of thrifts. On the other hand, the same factors which have delayed such a review—the continuing frailty of the thrift industry and uncertainty surrounding current legislation—will in all liklihood result in indefinite delay.

I do not think it is good policy nor is it fair to continue to deny equitable treatment to a whole class of institutions. Treasury took its initial position on this bill in 1981 and confirmed this position every year since 1981. During that period of time, unfortunately, Congress has been unable to resolve the bigger issues. I think it is time that we took the small step necessary to correct this obvious inequity.

Mr. Chairman and Committee members, I urge you to consider this bill promptly and to act favorably on H.R. 1343. Thank you again for this opportunity to air my views on this issue.

Chairman STARK. The Chair wants to apologize to the distinguished gentleman for being so tardy in getting around to his bill in this session. And it is one we have discussed, and I am aware of the inequity that exists; and I believe it exists only in the State of Washington.

Is that correct?

Mr. LOWRY. Well, I am told there are only 22 stock savings banks in the entire United States. The State of Washington has quite a few. In fact, some of the stock savings banks, this would not even apply to. So there are very few institutions that I know.

Chairman STARK. Any members wish to inquire?

Mr. SCHULZE. No questions, Mr. Chairman.

Chairman STARK. Thank you very much.

Mr. LOWRY. Thank you, Mr. Chairman.

Chairman STARK. Our next witness is Mikel Rollyson, tax legislative counsel for the Treasury Department, who will be given a free play to romp through the bills that are before us today.

And it is my understanding, Mike, that you are going to basically summarize for us whether the Treasury supports, opposes, or is indifferent to each of the bills, and make that a part of the record; and that you do have a rather lengthy tome. And it is also my understanding that you would like to have that appear in the record in its entirety.

STATEMENT OF MIKEL M. ROLLYSON, ACTING TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY

Mr. ROLLYSON. Yes. I promise not to read the whole thing. I know you have numerous witnesses.

Chairman STARK. With that in mind, you may proceed in any manner you desire.

Mr. ROLLYSON. I would like to summarize our written statement and keep my oral statement rather short. There are several of these bills which the Treasury does support, and I would like to summarize briefly those that we do support for you.

H.R. 2129 relates to the allocation of property taxes among tenant shareholders in housing cooperatives. We believe this bill would result in taxes attributable to the tenant shareholder in housing co-ops being allocated more fairly among those shareholders. And, therefore, we have no objection to that bill.

H.R. 2686 would remove an unintended impediment to certain management companies from electing to be treated as business development companies. This provision would permit business development companies to be eligible for the regulated investment company provisions of the Internal Revenue Code, and permit those organizations to pass through income received by such organizations.

We believe that there is an unintended impediment right now to companies making the business development company election, and therefore we have no objection to that bill.

H.R. 4779, which Mr. Thomas earlier testified on, we also would support. And we agree with his analysis that this was an unintended result of the windfall profits tax. And we would remove the windfall profits tax as a factor in the exchanges of crude oil for residual fuel oil which will be used in enhanced recovery processes. We do support that bill, as well.

Finally, we support H.R. 5199, which, as you well know, would confirm that section 278(b) of the Internal Revenue Code applies to jojoba plants. This bill is, in our view, a restatement of what is current law; it is the position in existing regulations.

But, nevertheless, to remove any question about those provisions, we would support that bill.

Chairman STARK. Mike, in that instance, do you have a view on the desirability of making that a 1976 effective date, in regard to H.R. 5199?

Mr. ROLLYSON. I think it would be desirable to make it a 1976 effective date to remove any question that jojoba plants were covered from the inception.

Chairman STARK. Thank you.

From the inception?

Mr. ROLLYSON. That is correct.

In addition, we agree with the approach in H.R. 5022, which would deny percentage depletion allowance to lease bonuses and advance royalties. Since the *Engle* decision by the Supreme Court, which this bill would reverse, Treasury has announced a ruling which provides a reasonable interpretation of section 613A; and we do believe that Congress should examine closely the incentives provided by percentage depletion generally when examining whether or not H.R. 5022 should be enacted.

The remaining bills before the committee today the Treasury Department opposes, and I will briefly summarize my opposition to those bills.

H.R. 700 would permit a deduction for travel and transportation of certain construction workers. We share the concern for travel expenses that are incurred by workers who must travel a great distance to temporary job sites. Nevertheless, we oppose a special rule designed for a particular class of taxpayers which is not of general application.

Moreover, this bill would not cure the uncertainty of current law regarding what is temporary employment, a problem that has been particularly perplexing. We do have a project underway which would address this issue in a general way, and we think there should be no legislation designed for a particular class but rather it should be legislation which will address this problem across the board.

Chairman STARK. Can you give us an idea of when we might get a look at that regulation underway now?

Mr. ROLLYSON. I would hope we would have that out before the end of the year, Mr. Stark. But we have an enormous——

Chairman STARK. To apply to 1985 income for the construction workers?

Mr. ROLLYSON. Yes.

Chairman STARK. Thank you.

Mr. ROLLYSON. H.R. 907 would extend the section 119 exclusion for certain meals provided for the convenience of employees on the premises of the employer to meals provided off the premises of the employer. We oppose this bill, as it would essentially convert the section 119 exclusion into a fringe benefit of general applicability.

Congress has just considered in some detail the taxation of fringe benefits, and we do not believe that that issue ought to be reopened at this time. And we want to emphasize that section 119 is not a fringe benefit provision, and we would oppose converting that provision into a fringe benefit.

H.R. 1343 would liberalize the bad debt deduction for stock savings banks, as Mr. Lowry described it earlier. It would extend to those banks the rules applicable to mutual savings banks.

We have concerns about the rules generally with respect to the deduction for bad debt reserves of thrift institutions. The deregulation of the thrifts has brought the activity of the thrifts much more closely in line with general activity of commercial banks, and we would oppose extending the bad debt deduction at this time. Rather, we think that issue ought to be looked at in connection with a comprehensive review of the taxation of thrift institutions.

H.R. 1773 would exempt from the unrelated business income tax certain sales and exchanges of membership lists or donor lists. The sale or rental of these lists is a commercial activity which has been viewed by the Treasury as being subject to the unrelated business income tax, and the courts have recently agreed with that view. We continue to believe that these activities should be subject to tax and would oppose this bill.

H.R. 3388 would provide retroactive relief for a few specified individuals by making section 252 of ERTA, enacted in 1981, applicable to transactions that occurred in 1973. We strongly oppose this special relief measure which is of retroactive nature.

H.R. 3528 and H.R. 3284 would permit freight forwarders and taxpayers with bus operating authorities to deduct the loss in value of their operating authorities attributable to deregulation of the trucking industry.

Section 266 of ERTA provided similar relief to motor carriers in 1981, but that provision came in over the objections of Treasury. For the same reasons that we objected in 1981, we would oppose both of these bills. The rights in question do still have substantial value, and they continue to be required by the ICC. And we continue to believe that the loss, any loss, in value of these rights should be recognized in accordance with general tax principles only when that loss is recognized through a taxable event.

H.R. 4167 would exempt certain oil and gas income received through limited partnerships from the unrelated business income tax if received by schools, pensions, and individual retirement accounts. In addition, the bill would exempt certain oil and gas income from the debt-financed property rules.

We oppose both aspects of this bill. The alleged rationale for the bill is that the income in question is passive in nature, like rents, royalties, dividends, and interest which are currently not subject to the unrelated business income tax. Nevertheless, we have several concerns with extending those exceptions to this type of income.

It is not at all clear that this income is of the same passive nature. The rationale for this bill would lead to exempting all income received by tax-exempt organizations through limited partnership vehicles from the unrelated business income tax. And, more importantly, the passive nature of the income is not the most important question here; rather, it is whether or not there would be a competitive advantage gained by the tax-exempt organization having the ownership or significant interest in the activities.

Finally, we do not believe that the debt-financed property rules should be significantly whittled down to any degree, and the bill as drafted would not provide adequate protection for the debt-financed property rules.

Finally, H.R. 4507 would allow the investment tax credit to be passed through to members of section 501(d) organizations. These organizations are essentially apostolic organizations which conduct an activity in a communal fashion. The 501(d) organizations are subject to a special tax regime which provides for a single tax to be provided at the member level, even though the organization may in fact be a corporation in form.

The 501(d) scheme, taxing of members on their proportionate share of the income as dividend income, was created to avoid the accumulated earnings tax problems facing these organizations.

The bill, as provided, would extend to these organizations certain benefits similar to those provided to partnerships in sub-S corporations; primarily, the ability to pass through the investment tax credit.

We would oppose this, as it would give a competitive advantage to these types of organizations; and, perhaps more importantly, would lead to extending other passthrough benefits to these organizations, and perhaps ultimately to the creation of a new passthrough vehicle of general application which we would not support as we already have enough pass-through vehicles in the Internal Revenue Code.

That concludes my prepared remarks, Mr. Chairman. And if you have any questions, I would be glad to address them.

[The prepared statement follows:]

STATEMENT OF MIKEL M. ROLLYSON, ACTING TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY

Mr. Chairman and Members of the Subcommittee, I am pleased to have the opportunity to present the views of the Treasury Department on the following bills: H.R. 700, relating to the deduction of travel and transportation expenses of construction workers; H.R. 907, which would expand the exclusion for employer-provided meals to cover meals provided off the premises of the employer; H.R. 1343, relating to the deduction for bad debts by stock savings banks; H.R. 1773, which would exempt from unrelated business income tax the income from the sale or exchange of membership lists; H.R. 2129, relating to the allocation of property taxes among tenant-stockholders in cooperative housing corporations; H.R. 2686 relating to the taxation of business development companies; H.R. 3388, which would make section 252 of the Economic Recovery Tax Act of 1981 applicable to certain transactions that occurred in 1973; H.R. 3284, and H.R. 3528, relating to the amortization of bus and freight forwarder operating authorities; H.R. 4167, which would exempt from unrelated business income the income received by schools, pension trusts and IRAs from oil and gas limited partnership investments; H.R. 4507, which would permit section 501(d) organizations to pass-through the investment tax credit to its members; H.R. 4779, relating to the application of the windfall profit tax to certain exchanges of crude oil for residual fuel oil; H.R. 5022, which would deny percentage depletion with respect to oil and gas lease bonuses and advance royalties; and H.R. 5199, relating to the application of section 278(b) to inedible fruits and nuts.

I will discuss each bill in turn.

H.R. 700

DEDUCTION FOR TRAVEL AND TRANSPORTATION EXPENSES OF CONSTRUCTION WORKERS

Current law

In general, a taxpayer is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on a trade or business. No deduction is allowed for personal, living, or family expenses, including the cost of commuting to and from work. However, it is sometimes difficult to delineate between personal transportation and travel expenses which are non-deductible and those which are properly deductible as business expenses.

In 1953, the Service ruled that daily transportation costs incurred by a taxpayer in traveling from the metropolitan area in which he regularly worked to a temporary job site outside that metropolitan area were deductible. In 1971, however, the Tax court held that daily transportation costs were non-deductible regardless of the temporary nature of the job or the distance traveled. The IRS formally adopted the Tax Court's rationale in 1976. Subsequently, Congress imposed a moratorium on the implementation of the Service's position and required that expenses paid or incurred in connection with travel between taxpayer's residence and place of work for the period beginning after 1976 and before June 1, 1981, be governed by the rules in effect prior to 1976.

Current law also provides that taxpayers who are away from home may deduct business expenses, including the cost of transportation, incurred in connection with temporary employment away from the taxpayer's regular or principal place of employment. Whether employment is temporary, as opposed to permanent or indefinite, depends upon an analysis of the facts and circumstances surrounding the employment arrangement. The Internal Revenue Service recently issued a ruling, Rev. Rul. 83-82, 1983-22 I.R.B. 5, which provides guidelines to determine whether an employment arrangement is temporary.

Description of H.R. 700

H.R. 700 would amend Code section 162 to provide a special rule for the travel and transportation expenses incurred by construction workers. This rule defines as a "temporary" job site any job at a site located more than 30 miles from the construction worker's principal place of residence for the first two years that the worker is employed at that job site. For periods of employment after the initial two-year period, whether or not the job site is temporary would be determined based on an examination of all the facts and circumstances, except that the following would not be taken into account:

(a) the fact that the worker has already been employed at the job site for the past two years;

(b) the fact that the worker's employment at the job site is of indefinite duration.

In addition, the IRS could not deem, by rule or regulation, that any length of time either automatically or presumptively makes the job other than temporary. For purposes of this bill, the term "construction worker" means any individual employed, whether as a skilled, semiskilled, or unskilled laborer, in the building or construction industry, but does not include clerical or management employees. The proposed amendment would be effective upon enactment.

Discussion

The apparent intention of the bill is to permit construction workers to deduct all travel and transportation expenses incurred in connection with employment at a job site located more than 30 miles from the worker's principal place of business, at least for the first two years the worker is employed at that site. Treasury shares this Subcommittee's concern about the fair treatment of workers who must travel many miles from their residence to temporary jobs. The difficulties inherent in distinguishing "temporary" assignments, as is required by current law, from "indefinite" assignments has lead to significant uncertainty in this area. However, Treasury must oppose H.R. 700.

We oppose the adoption of a special travel deduction rule governing the tax liability of a class of taxpayers defined by occupation without regard to similarly situated taxpayers who have different occupations. Moreover, any rule adopted to provide a deduction for workers with a constantly shifting workplace who must travel long distances to reach their job sites should be designed to remedy the uncertainty of current law. Under this bill, the IRS would be precluded from establishing a bright line for defining temporary employment. We believe such a rule is desirable to provide guidance to taxpayers and those who must administer these provisions of the tax law.

In addition, there is an active regulations project which addresses the subject of travel expenses incurred in connection with temporary jobs. We hope that the project will be completed and that new regulations will be promulgated in proposed form in the near future. Because this area is now under intensive study and because we intend to propose rules of general application in this area, we must oppose the bill.

H.R. 907

EXPANSION OF EXCLUSION FOR EMPLOYER-PROVIDED MEALS TO COVER CERTAIN OFF-PREMISE MEALS

Current law

In general, current law under section 119 provides that the value of meals furnished to an employee by or on behalf of his employer is excludable from the employee's gross income if the meals are furnished on the business premises of the employer and are furnished for the convenience of the employer. The long-standing interpretation of section 119 requires that the meals be furnished at the place of employment of the employee for a substantial noncompensatory business reason of the employer, such as to have the employee available for emergency call during his meal period. The determination of whether a meal is furnished for the convenience of the employer is made by examining the relevant facts and circumstances.

Under the Tax Reform Act of 1984, the value of meals provided to an employee at an eating facility operated by an employer for employees is treated as a de minimus fringe benefit and excluded from income if (1) the facility is located on or near the business premises of the employer, (2) revenue derived from the facility normally equals or exceeds the direct operating costs of the facility, and (3) certain discrimination requirements are met in the case of officers, owners, or highly compensated employees.

Description of H.R. 907

H.R. 907 would amend Code section 119 to extend the scope of the meals exclusion to cases where meals are furnished off the business premises of the employer where:

(a) the employer is unable to justify economically the operation of on-premises eating facilities;

(b) the employer does not provide on-premises eating facilities at the employee's place of employment;

(c) meals are provided in kind, not in cash; and

(d) meals are provided within a time frame consistent with the employer's established meal schedule.

Discussion

Treasury opposes H.R. 907. As a general matter, the value of property (including meals) received in connection with the performance of services should be treated as income for purposes of the income tax provisions and as wages for purposes of the withholding and employment tax provisions of the Code. Section 119 was enacted as part of the 1954 recodification of the Internal Revenue Code to clarify the tax status of meals and lodging furnished to an employee by his employer in circumstances where the benefits provided were necessary to the functioning of the employer's business. In enacting section 119, Congress overruled prior Service regulations which only permitted an exclusion for meals or lodging furnished to employees for the convenience of the employee if it was evident from the circumstances that the meals or lodging did not represent compensation. Congress rejected this test and instead provided that the basic test for exclusion is whether the meals or lodging are furnished primarily for the convenience of the employer. Consistent with this interpretation, Congress also added an additional restriction—that meals subject to the exclusion must be taken on the business premises of the employer. Thus, the conditions for exclusion under section 119 represent an attempt to establish objective standards by which the exclusion is limited to those situations were meals are provided primarily to enable the employee to preform his job. The requirement that meals be furnished on the employer's premises is an essential and logical part of this test.

The amendments proposed by H.R. 907 would change section 119 from an exclusion based on business necessity into a statutory fringe benefit generally available to a substantially enlarged number of taxpayers. Such an expansion is not consistent with the original purpose of section 119 which was to permit a statutory exclusion where business requirements demanded that an employee take his meals on the business premises. Moreover, Congress has recently addressed the taxation of certain employer-provided meals as fringe benefits in the Tax Reform Act of 1984. This new provision does not amend section 119. Instead, it provides a new section 132 of the Code which excludes from employee income certain fringe benefits, including, in certain circumstances, the excess of the value of meals provided to an employee by an employer at an employer-operated eating facility over the fee charged for the meal. Because Congress has just reviewed the taxation of fringe benefits in a comprehensive way, we do not think this bill represents an appropriate time to re-open the subject of fringe benefits taxation.

We also are opposed to introducing into Section 119 a rule requiring analysis of the employer's ability to provide on-premises eating facilities. Requiring the Service to determine in each case whether or not the employer can economically justify the operation of an on-premises cafeteria would, we believe, create a standard that cannot be effectively administered.

Finally, H.R. 907 would represent a significant erosion of the tax base. Revenue estimates show that enactment of this legislation would result in a $320 million annual revenue loss in the fifth year after enactment.

H.R. 1343

BAD DEBT RESERVES OF STOCK SAVINGS BANKS

Current law

A thrift institution may compute the addition to its bad debt reserve using the percentage of eligible loans method, the experience method or the percentage of taxable income method. The percentage of taxable income method is available to a thrift institution to compute the addition to its bad debt reserve for qualifying real property loans if a minimum percentage of its assets consist of certain eligible investments (primarily residential mortgages). The more liberal bad debt deduction available to thrift institutions under the percentage of taxable income method is essentially a subsidy designed to encourage investment in residential mortgages.

To claim the maximum deduction (which is generally equal to 40 percent of taxable income), a savings and loan association or stock savings bank must hold at least 82 percent of its total assets in eligible investments. The deductible percentage of taxable income is reduced if fewer then 82 percent of total assets are eligible investments.

In contrast, a mutual savings bank must hold only 72 percent of its assets in eligible investments to take advantage of the maximum deduction. The allowable deduction for a mutual savings bank is also reduced if the percentage of eligible investments declines below 72 percent.

Description of H.R. 1343

H.R. 1343 would equate the bad debt reserve provisions applicable to a stock savings bank with those applicable to a mutual savings bank and allow a stock savings bank to claim the maximum bad debt deduction using the percentage of taxable income method if at least 72 percent of its assets consist of eligible investments.

Discussion

Prior to the the Economic Recovery Tax Act of 1981 (ERTA), Federal and state legislation had been enacted permitting mutual savings banks to convert to stock ownership to allow such savings banks to raise new capital and achieve other financial objectives. Before the enactment of ERTA, though, stock savings banks were not entitled to claim additions to bad debt reserves using the percentage of taxable income method. ERTA allowed a mutual savings bank that converted to a stock savings bank to compute its bad debt deduction under the percentage of taxable income method under the same rules applicable to stock savings and loan associations.

ERTA provided that a stock savings bank is eligible for the maximum deduction under the percentage of taxable income method only if it invests 82 percent of its assets in eligible investments. This requirement is in contrast to the more liberal 72 percent investment standard applicable to mutual savings banks. The legislative history to ERTA indicates that the rationale for this distinction is that a stock savings bank is more like a stock savings and loan association than a mutual savings bank.

Congress created the distinction between savings banks and savings and loan associations under Section 593 in 1962 to recognize historical differences in the investment powers of savings banks and savings and loan associations. Savings banks traditionally enjoyed broader investment powers and were permitted to make more non-mortagage investments than savings and loan associations. Deregulation of thrift institutions in general, however, has expanded the investment powers of all types of thrift institutions. As a result, thrifts have become increasingly similar to commercial banks.

Increasing deregulation of thrift institutions and the resulting competition among all sectors of the financial industry suggests that the policy rationale for the special bad debt deduction rules for thrifts should be reexamined. Until this reexamination occurs, Treasury cannot support incremental changes to section 593, such as H.R. 1343. Decisions in this area should be based on a comprehensive review of all of the pertinent tax and economic policy issues affecting the thrift industry.

H.R. 1773

EXEMPTION FROM UNRELATED BUSINESS INCOME TAX FOR SALES, RENTALS, OR EXCHANGES OF NAMES FROM DONOR AND MEMBERSHIP LISTS

Current law

The Internal Revenue Code contains numerous special provisions designed to promote certain activities ("exempt activities") of nonprofit organizations that provide substantial public benefit. These special provisions include (i) deductions from income for amounts contributed to or for the use of specified organizations that conduct the exempt activities and (ii) exemption from income taxation for organizations conducting such activities. These two benefits serve distinct purposes. The deduction allowed for contributions to the specified organizations is intended to assist the organizations in obtaining the financial support necessary to conduct the exempt activities. The income tax exemption for the organization is intended to permit the organization to conduct exempt activities without incurring any Federal income tax liability.

Prior to 1950, the tax exemption of organizations conducting exempt activities extended to all income received, whether from the conduct of exempt or nonexempt activities. Furthermore, prior to 1950, it was unclear whether a "feeder" organization that carried on a trade or business for profit as its primary activity and paid all its income to a tax-exempt organization could qualify for exempt status. In 1950, Congress enacted legislation that imposed a tax on income received by exempt organizations from unrelated business activities and denied exempt status to "feeder" organizations. Since the 1950 legislation, it has been clear that the receipt of income is not entitled to exemption from taxation solely because the income will be used for exempt purposes. Rather, exemption of income from taxation depends upon the nature of the activity that produces the income. For example, income generated by activities that further exempt purposes and income generated by certain forms of investment activity traditionally engaged in by tax-exempt organizations are not subject to taxation. The tax on unrelated business income, however, distinguishes income generated by commercial activities from income earned through exempt purpose activities and traditional forms of investment. The primary purpose for taxing income from commercial activities of tax-exempt organizations and income of "feeder" organizations is to equalize the tax treatment of commercial, nonexempt activities, regardless of the type of entity that conducts the activity. This prevents tax-exempt organizations from gaining unfair advantage over their taxable competitors by trading on their tax exemptions.

Description of H.R. 1773

H.R. 1773 would exempt from the unrelated business income tax income from the sale, exchange, or rental by certain tax-exempt organizations of names of donors to, or members of, the organizations. The bill accomplishes this by prohibiting the treatment of such activities as a trade or business for purposes of defining an unrelated trade or business. The bill applies only to sales, exchanges, or rentals by organizations, contributions to which are deductible as charitable contributions.

Discussion

The activity of selling or renting names from mailing lists is a common commercial practice engaged in by many taxable entities as well as by tax-exempt organizations. While much of the income earned by tax-exempt organizations from sales or rentals of their donor or membership lists may be received from other tax-exempt organizations, these transactions are conducted in a commercial manner similar to that by which taxable entities sell or rent mailing lists. Sales and rentals of donor, membership, and mailing lists also occur between taxable and tax-exempt organizations. We consider it appropriate for income from such a common commercial activity to be subject to taxation. In 1981, the Court of Claims held that income received by the Disabled American Veterans from the sale of its mailing lists is unrelated business income.

When an organization exchanges its donor or membership lists with another organization, it is in effect selling or receiving rent for its list and purchasing or paying rent for the other organization's list. The fact that payment is made in kind rather than in cash does not change the essentially commercial nature of the sale or rental activity.

The argument made in support of exempting income from sales, rentals, or exchanges of donor lists from the unrelated business income tax is that such sales, rentals, or exchanges are necessary to maintain the lists. We recognize that, because of attrition, an organization must regularly add new names to maintain its donor lists. Nevertheless, the sale or rental of the donor list to others does not provide the organization with such new names. Of course, the sale or rental becomes associated with the acquisition of new names where the income from the commercial activity is used to buy or rent lists of other organizations or where the sale or rental is accomplished through an exchange of lists. As discussed above, however, the policy is well established that it is the nature of the activity that produces the income, not the use to which the income is dedicated, that determines whether exemption should be granted. Treasury opposes exemption from the unrelated business income tax of income from the sale, rental, or exchange of donor or mailing lists because such an exemption would be directly contrary to this established principle. We do not believe the tax law should be changed to give tax-exempt organizations a competitive advantage in the business of selling, renting, or exchanging donor or membership lists.

H.R. 2129

ALLOCATION OF PROPERTY TAXES AMONG TENANT-STOCKHOLDERS IN COOPERATIVE HOUSING CORPORATIONS

Current law

The "owner" of a cooperative housing unit (generally an apartment in a building containing several apartments) actually owns shares of stock in a corporation which legally owns or leases the real estate including the unit. In addition, the owner enters into an agreement with the corporation entitling him to occupy the unit and providing for payment of rent (usually called a "maintenance" payment). The maintenance payments, in part, cover the corporation's payments of mortgage interest and real property taxes with respect to the property.

Since the owner of the unit (the "tenant-stockholder" of the cooperative housing corporation owning the property) would be entitled to deduct payments of taxes and interest with respect to his unit if he owned the unit directly, section 216 allows the tenant-stockholder to deduct his "proportionate share" of: (1) the real property taxes allowable as a deduction to the corporation under section 164 which are paid or incurred by the corporation on the houses or apartment building and on the land on which such houses or building are situated, and (2) the interest allowable as a deduction to the corporation under section 163 which is paid or incurred by the corporation on its indebtedness contracted in connection with the acquisition, construction, alteration, rehabilitation, or maintenance of the houses or apartment building, or in the acquisition of the land on which the houses or apartment building are situated.

Under section 216(b)(3), the term "proportionate share" means the proportion which the tenant-stockholder's stock in the cooperative housing corporation bears to the corporation's total outstanding stock. This rule controls a tenant-stockholder's allowable deduction for real property taxes even if state law (in conjunction with the corporation's by-laws) require him to pay a greater or lesser share of the corporation's real property tax liability.

However, under the laws of some jurisdictions, a tenant-stockholder's share of the corporation's real property tax liability is determined, not by reference to stockholdings, but by reference to the value of his unit. In particular, in California, under Proposition 13, if shares in a cooperative housing corporation that are associated with an apartment are sold or exchanged, the apartment is appraised for real estate tax purposes at its value at the time of the sale or exchange (usually resulting in an increased assessment with respect to the apartment). In such cases, the new purchaser generally is required to pay higher maintenance fees reflecting the increase in the corporation's real property tax payments that is attributable to the reappraisal of his apartment.

Notwithstanding the manner in which a cooperative housing corporation's real property tax liability is actually borne by its stockholders in such jurisdictions, section 216 currently does not permit new purchasers, who may make larger (or smaller) maintenance payments per share of stock than other tenant-stockholders, to deduct a proportionately greater (or lesser) share of the corporation's real property taxes compared to other tenant-stockholders whose apartments have not been reassessed. Rather, each tenant-stockholder is required to deduct his "proportionate share" (measured by stockholdings) of the increased real property taxes, even though his maintenance fee may not reflect the increase.

Description of H.R. 2129

H.R. 2129 would amend section 216(b)(3) to provide that, if the laws or ordinances of any State (or political subdivision thereof) require an allocation of taxes based on separate appraisals of some or all of the units owned by a cooperative housing corporation, the term proportionate share (with respect to such taxes) shall mean the amount allocated to those individual units pursuant to such laws or ordinances.

Under this amendment, a purchaser of an appreciated (or depreciated) apartment, who is required to pay maintenance fees proportionately higher (or lower) than his stockholdings to reflect the individual appraisal of his apartment, would be allowed a deduction for a share of the corporation's real property tax liability which takes into account the share of such liability that he actually bears.

Discussion

The Treasury Department supports H.R. 2129, with suggestions for minor technical changes.

Section 216(b)(3) currently does not take into account the possibility that a tenant-stockholder's actual share of the cooperative housing corporation's real property tax liability may differ from the proportion which his stock in the corporation bears to the corporation's total outstanding stock. Accordingly, where state or local law (together with the corporation's by-laws) requires that units be appraised separately, with the result that the tenant-stockholder with respect to a separately appraised unit bears the cost of real property taxes actually attributable to the unit, the allocation of allowable real property tax deductions does not reflect economic reality. H.R. 2129 would ensure that section 216(b)(3) reflects the actual tax burden borne by the cooperative housing corporation's shareholders.

While we support H.R. 2129, we believe that certain minor changes should be made to clarify its meaning. Specifically, we would: (1) replace the term "taxes" with the term "real property taxes", and (2) clarify that, in the case of a housing cooperative, some but all of the unit of which have been separately appraised, the term "proportionate share" with respect to units which have not been separately appraised must take into account amounts allocated to units which have been separately appraised.

H.R. 2686

TAX TREATMENT OF BUSINESS DEVELOPMENT COMPANIES

Current law

The Code permits certain corporations that qualify as "regulated investment companies" to deduct dividends paid to their shareholders and thereby avoid the double taxation that would otherwise be imposed on distributed corporate earnings. In order to qualify as a regulated investment company (or "RIC") for federal income tax purposes, a domestic corporation must meet several requirements. The corporation must derive 90 percent of its gross income from dividends, interest, and the sale of stocks and securities and must meet certain investment diversification requirements. In addition, section 851(a) of the Code requires (i) that the corporation be registered with the Securities and Exchange Commission at all times during the taxable year as a management company or as a unit investment trust under the

Investment Company Act of 1940, or (ii) if the corporation is a common trust fund or similar fund, that it be excluded from the definition of "common trust fund" under the Code and from the definition of "investment company" under the Investment Company Act of 1940.

The Small Business Incentive Act of 1980 (Public Law 96-477), amended the Investment Company Act to permit a closed-end company that provides capital and significant managerial assistance to small businesses to elect, subject to certain requirements, to register as a "business development company." A company is eligible to register as a business development company only if it would otherwise be required to register as a management company under the Investment Company Act. An eligible company that elects to be treated as and registers as a business development company is no longer required to register under the Investment Company Act.

Description of H.R. 2686

H.R. 2686 would amend present law to provide that any domestic corporation that registers as a business development company under the Investment Company Act of 1940, as amended, would be eligible for the conduit tax treatment applicable to RICs, subject to the requirements generally applicable in determining whether an investment company qualifies as a RIC. H.R. 2686 would apply to taxable years beginning on or after October 21, 1980 (the effective date of the 1980 amendments to the Investment Company Act).

Discussion

We support H.R. 2686 because it will remove federal income tax treatment as a factor in the determination by an otherwise eligible company of whether it will elect to be regulated under the securities laws as a business development company rather than as an investment company. The alternative form of regulation available under the Investment Company Act for business development companies was specifically designed for such companies in lieu of registration under the Investment Company Act and imposes less burdensome regulatory requirements than the requirements otherwise applicable to corporations required to register as investment companies. For example, a business development company is subject to less stringent restrictions regarding its capital structure and its ability to engage in transactions with affiliated persons. Thus, a corporation eligible to register as a business development company would generally find such registration to be preferable to registration as an investment company. Because the Code definition of a RIC has not been changed to reflect this new type of registration, however, a corporation can obtain the benefits of registration as a business development company only if it forgoes the pass-through treatment available to RICs under the Code. H.R. 2686 would remove this impediment.

We reiterate that a company can qualify as business development company for securities law purposes only if it otherwise would fall within the definition of an investment company. Hence, H.R. 2686 would not expand the class of corporations that can elect to be treated as RICs; rather, its effect would be that a closed-end management company, which is already eligible to be treated as a RIC for federal income tax purposes, does not lose that eligibility by electing to be regulated as a business development company.

Arguably, by providing "significant managerial assistance" to its portfolio companies, a business development company may engage in a higher level of activity than the passive investment companies for which Subchapter M was drafted. We do not believe, however, that this concern should necessarily preclude business development companies from obtaining the same tax treatment as other investment companies engaged in a similar level of activity. A better approach would be to consider whether any company engaging in a significant degree of activity should be eligible for taxation under Subchapter M.

Although we support H.R. 2686, we would recommend some changes in the bill as introduced. First, since registration as a business development company is in lieu of registration as a mangement company, we believe that the provisions of Parts I and III of Subchapter M will apply to a corporation meeting the definition of a business development company as if it were registered as a management company. Such a change would clarify that a business development company can qualify as a RIC only if it is registered throughout its taxable year as a business development company or as a management company. This change would also make it clear that section 851(e) could apply to a business development company. Finally, such a change would help clarify that a business development company electing conduit tax treatment under Subchapter M should be treated as a RIC for all purposes under the Internal Revenue Code, and not just for purposes of Subchapter M.

Second, the exception contained in H.R. 2686 for business development companies that are personal holding companies or that would be personal holding companies but for the application of section 542(c)(8) should be deleted. By making such companies ineligible to become RICs, H.R. 2686 is consistent with section 851(a) as it existed prior to this year. The Tax Reform Act of 1984, however, amended section 851(a) by deleting the prohibition against the election of RIC status by a personal holding company (although a RIC that is a personal holding company is subject to tax at the maximum corporate rate on its undistributed income). Since a personal holding company that is registered under the Investment Company Act as a management company may now elect to be treated as a RIC if its meets all other requirements, we see no reason why a personal holding company (or a company that would be a personal holding company but for section 542(c)(8)) that elects to be regulated as a business development company should forgo the opportunity to be taxed as a RIC, as long as its undistributed income is subject to tax at the highest corporate rate.

Finally, if enacted H.R. 2686 should be prospective only in its application. Since this legislation is designed to remove a tax disincentive to registration as a business development company, there is no reason to extend its benefits to companies that have previously decided to forgo RIC status by registering as business development companies. Accordingly, we would recommend that this legislation apply only to taxable years ending after the date of enactment.

H.R. 3388

APPLICATION OF SECTION 252 OF ERTA TO CERTAIN TRANSFERS IN 1973

Current law

Prior to the ERTA any taxpayer who received stock subject to section 16(b) of The Securities Exchange Act of 1934, (under which an "insider's" profit may be recovered by a corporation if the stock is sold within 6 months of receipt), was required to treat the value of the stock (less any amount paid) as compensation when received. Section 252 of ERTA revised this rule, on the theory that restrictions on transferability which are mandated by Federal securities laws or accounting principles should be taken into account in determining the time at which the value of the stock should be included in income. After ERTA, any taxpayer who receives stock subject either to section 16(b) or to the "pooling-of-interest" accounting rules will be treated as being subject to a substantial risk of forfeiture within the meaning of Code section 83 for the 6-month period during which the mandated restrictions apply. Thus, the employee will include in income, and the employer may deduct at the time the restriction lapses, the difference between the value of the stock at that time and the amount paid for the stock (if any). This provision applies to transfers after December 31, 1981.

Description of H.R. 3388

H.R. 3388 addresses the effective date of this section and would apply the above-described change in the restricted stock transfer rule prior to its effective date in the following narrowly defined set of circumstances:

The stock was acquired in November or December of 1973 under stock options granted in November or December of 1971;

The corporation granting the options was acquired in a tax-free reorganization occurring in December 1973;

The fair market value of the stock dropped by 50 percent during the holding period before sale;

Substantially all the stock was sold in 1975 or 1976.

If these conditions are met, the taxpayer may elect to apply the provisions of section 252(a) and (b) of ERTA to the extent that the credits or refunds produced thereby do not exceed $100,000 per taxpayer (disregarding interest).

H.R. 3388 is in substance identical to H.R. 4577, introduced in 1982. The narrowly defined set of circumstances described in these bills is meant to describe particular beneficiaries.

Discussion

Treasury opposes H.R. 3388 for a number of reasons. First, because the bill is intended to grant special tax relief to a few individuals, it is inequitable and is the antithesis of sound tax policy. The tax laws cannot be administered fairly if special exceptions are made for favored individuals.

Second, Treasury has consistently opposed any retroactive application of the ERTA change in the restricted property rules. This opposition is consistent with our general opposition to retroactivity even where, as here, the substantive change in the law is sound.

Third, retroactivity is particularly inappropriate in this case because the bill would permit taxpayers to elect to open years closed by the statute of limitations. The purpose of a statute of limitations is to prevent both the Internal Revenue Service and taxpayers from reopening issues after a certain period of time regardless of how meritorious the position may be. This legislation would clearly violate that rule.

H.R. 3528

DEDUCTION FOR LOSS IN VALUE OF FREIGHT FORWARDER OPERATING AUTHORITIES

H.R. 3284

DEDUCTION FOR LOSS IN VALUE OF BUS OPERATING AUTHORITIES

Current law

On July 1, 1980, the Motor Carrier Act of 1980 was enacted to reduce regulation of the interstate motor carrier industry. The Act made it easier for motor carriers to obtain operating authorities from the Interstate Commerce Commission. Although the legislative deregulation of the motor carrier industry applied only to motor contract carriers and motor common carriers, and not to freight forwarders, the ICC, on its own initiative, and concurrently with the enactment of the Motor Carrier Act, substantially reduced entry restrictions for freight forwarders as well. As a result of this legislative and administrative easing of regulation, the value of previously granted operating authorities held by motor carriers and freight forwarders has declined.

Similarly, the bus Regulatory Reform Act of 1982 (enacted on November 19, 1982), in deregulating the intercity bus industry, substantially eased entry into the intercity bus business. As a result of deregulation, the value of previously granted bus operating authorities has declined.

Under section 165(a) of the Code, a deduction is allowed for any loss incurred in a trade or business which is evidenced during the taxable year by a closed and completed transaction and fixed by an identifiable event. The amount of any deduction allowed may not exceed the adjusted basis of the property involved. No deduction is allowed, however, for a mere decline in value of property. These rules have been applied by the courts to deny deductions for the diminution in value of an operating permit or license in circumstances closely comparable to those presented by the reduced regulation of interstate freight forwarders and intercity bus operators.

After the interstate motor carrier industry was legislatively deregulated, Congress enacted section 266 of the Economic Recovery Tax Act of 1981, as a special relief provision for taxpayers who held motor carrier operating rights at that time. Under section 266, a deduction is allowed ratably over a 60-month period for taxpayers who held one or more motor carrier operating authorities on July 1, 1980. The term "motor carrier operating authority" means a "certificate or permit held by a motor common or contract carrier of property and issued pursuant to subchapter II of chapter 109 of title 49 of the United States Code." Section 266 provides no relief for taxpayers which held operating authorities as freight forwarders.

Description of H.R. 3528

H.R. 3528 would amend section 266 of the Economic Recovery Tax Act of 1981 to define the term "motor carrier operating authority" to include a "certificate or permit held by a motor common or contract carrier of property or a freight forwarder." Under this amendment, taxpayers holding operating authorities as freight forwarders on July 1, 1980 would be entitled to deduct ratably over a 60-month period (commencing with the month of July 1980, or, at the election of the taxpayer, with the first month of the taxpayer's first taxable year beginning after July 1, 1980) the aggregate adjusted basis of all all motor carrier operating authorities held by the taxpayer on such date, including those held as a freight forwarder.

Description of H.R. 3284

Under H.R. 3284, a deduction would be allowed ratably over a 60-month period (generally beginning with the later of the month of November 1982 or, if later, at the election of the taxpayer, the first month of the taxpayer's first taxable year beginning after November 19, 1982) for taxpayers holding one or more bus operating authorities on November 19, 1982. The amount of the deduction would be the aggregate adjusted basis of all bus operating authorities held by the taxpayer on that date or acquired thereafter under a contract that was binding on that date, subject to a per-taxpayer limitation of $5 million. The bill also provides authority for the Treasury Department to prescribe regulations under which, for purposes of this deduction, if a controlling stock interest in a corporation holding eligible bus operating authorities was purchased by a person or group of noncorporate persons within a 12-month period, the corporation would be able to elect to allocate to the operating authorities a ratable portion of the purchaser's basis in the corporation's stock. This election would be available only if the stock was acquired on or before November 19, 1982, or pursuant to a binding contract in effect on that date.

For purposes of the $5 million limitation, a corporation which is a member of an affiliated group would be treated as a separate taxpayer.

Discussion

H.R. 3528 would expand the scope of section 266 of the Economic Recovery Tax Act of 1981, which allowed taxpayers who held operating authorities as motor carriers of property to amortize the adjusted basis of those operating authorities over a 60-month period. H.R. 3284 would enact substantially similar rules for taxpayers who held bus operating authorities prior to deregulation of the intercity bus industry.

Treasury opposed the enactment of section 266 on the ground that even though the deregulation of the trucking industry caused a decline in the value of the operating rights of motor carriers, those rights continue to have value, since the ICC continues to require a staxpayer to secure such rights in order to conduct a trucking business. We also pointed out that if it was decided that special tax relief should be given to affected motor carrier operators, the proper amount of the loss deduction should be the excess of the taxpayer's basis in the operating rights over the post-deregulation value of those rights, not the full amount of the taxpayer's basis in the operating rights.

I would like to emphasize that the deregulation of motor carriers (including freight forwarders) and intercity bus operators is not different from any other deregulation that causes a diminution in value of a license or operating right. Other industries, most notably the airline industry, have been deregulated without the grant of any special tax relief for this reduction in value.

Moreover, our tax system taxes gains and permits a deduction for losses only when those gains or losses are recognized by an identifiable event; in the case of gains or losses attributable to property, this typically occurs upon the sale or exchange of the property. Permitting a current deduction for a decline in the value of assets prior to disposition while not taxing unrealized gains is contrary to our present system of taxation and sets an unfortunate precedent. While we acknowledge that no distinctions can be made between the deregulation of motor carriers, freight forwardes, and bus operators, if H.R. 3528 and H.R. 3284 are enacted the door will be open for all other deregulated industries to seek similar relief. Therefore, we must oppose H.R. 3528 and H.R. 3284 on the same ground as that on which we opposed section 266 of the Economic Recovery Tax Act of 1981.

Additionally, in the case of H.R. 3284, we are concerned that treating members of an affiliated group of corporations as separate taxpayers for purposes of the $5 million per-taxpayer limitation would create an unwarranted distinction between a parent corporation that purchased (before November 19, 1982) a controlling interest in a single subsidiary holding multiple bus operating authorities and a parent corporation that purchased (before November 19, 1982) multiple subsidiaries each of which held a single bus operating authority. Similarly, an unwarranted distinction would exist between a corporation which expended funds to acquire bus operating authorities directly, and one which acquired operating authorities indirectly by purchasing the stock of corporations already holding operating authorities. In both cases, more favorable treatment would be given to the affiliated group more members of which held operating authorities. Accordingly, we oppose the provision of H.R. 3284 that provides that members of an affiliated group would be treated as separate taxpayer for purposes of the $5 million per-taxpayer limitation.

H.R. 4167

EXEMPTION FROM TAX ON UNRELATED BUSINESS INCOME FROM OIL AND GAS INVESTMENTS BY SCHOOLS, PENSION TRUSTS, AND INDIVIDUAL RETIREMENT ACCOUNTS

Current law

As discussed earlier, Congress long ago determined that a tax should be imposed on income earned by exempt organizations from business activities that are unrelated to their exempt purposes. The primary purpose of the tax is to prevent exempt organizations engaged in commercial activities from having a competitive advantage over taxable entities. Exemptions from the tax on unrelated business income are provided for rents, royalties, dividends, and interest. The legislative history shows that these particular types of income were exempted because they are "passive" in character, are unlikely to result in serious competition for taxable businesses having similar income, and had long been recognized as a proper source of revenue for educational and charitable organizations.

The passive income exceptions generally do not apply, however, if the income is derived from property that is acquired or improved with borrowed funds. In general, the rules relating to debt-financed property provide that a share of any income from debt-financed property, proportional to the ratio of debt on the property to the adjusted basis of the property, is treated as income from an unrelated trade or business. An exception to the debt-financed property rules provides that income from debt-financed real estate investments of qualified pension trusts and certain educational institutions are not subject to tax, provided certain conditions are satisfied.

The original rules relating to debt-financed property were developed in response to abusive sale-leaseback transactions between tax-exempt organizations and taxable owners of active businesses. These transactions typically involved a tax-exempt organization's purchase of an active business, financed primarily by a contingent, nonrecourse note, followed by a lease of the assets of the business to the seller. The effect of these transactions was to convert the ordinary income of the business into capital gains for the seller while allowing the tax-exempt organization eventually to acquire property with little or no investment of its own funds. The primary objection to sale-leaseback arrangements involving borrowed funds was that they permitted an organization's tax exemption to benefit the taxable seller, either by conversion of ordinary income to capital gain or by payment of a higher price for the the property than a taxable purchaser would pay.

Enactment in 1950 of a tax on income from certain leases was insufficient to prevent abuse because new forms of transactions involving leveraged investments quickly developed. In response to these new transactions, the provision was strengthened in 1969 by subjecting to the unrelated business income tax the income received from all kinds of debt-financed property. This broad revision reflected concern not only with existing sale-leaseback transactions, but with the possibility of other abusive uses of leveraged investments by tax-exempt organizations.

Description of H.R. 4167

H.R. 4167 would provide an exemption from the tax on unrelated business income for income received by qualified pension trusts, individual retirement accounts, and educational organizations from investments as limited partners in partnerships holding working interests in domestic oil and gas wells. This exemption would not apply if the general partner of the limited partnership were related to one or more of the tax-exempt limited partners. In addition, the exemption would not apply to income allocated to a limited partner during a partnership year in which allocations of deductions, losses, credits, and cash distributions were not consistent with allocations of income or gain. Use of multi-tier partnership or other arrangements for the principal purpose of avoiding these limitations on allocations would be prohibited. The limitations would not apply to allocations of depreciation, depletion, or gain or loss with respect to property contributed to a partnership which are made, in accordance with section 704(c)(2), on a nondiscriminatory basis between exempt and nonexempt limited partners.

The bill also would exempt from the debt-financed property rules a pension trust's, IRA's, or educational institution's share of a limited partnership's income from working interests in domestic oil and gas wells unless—

(1) the acquisition price of the working interest is not a fixed amount determined as of the date of acquisition;

(2) the amount of indebtedness incurred in acquiring, developing or operating the working interest or any other amount payable with respect to such indebtedness, or the time for making any payment of any such amount, is dependent, in whole or in part, upon any revenue, income, or profits derived by or from such limited partnership;

(3) the working interest is at any time after its acquisition leased by the limited partnership to the person who sold it to the limited partnership or to certain persons related to the seller;

(4) the working interest is acquired from, or at any time after the acquisition is leased by the limited partnership to, certain persons related to the pension trust or educational organization; or

(5) the seller of the working interest, certain persons related to the seller, or certain persons related to the pension trust, IRA or educational organization provide the limited partnership, the pension trust, or the educational organization with nonrecourse financing in connection with the purchase of the working interest and such financing is subordinate to any other debt on the property or bears interest at a rate which is significantly lower than the rate otherwise available.

However, the last three of these restrictions would not apply to any acquisition, lease, farmout, or other transfer of working interests to a person related to the general partner, provided the terms of such transfer are consistent with the terms of similar transfers in the geographic area.

Discussion

Treasury opposes H.R. 4167. The exemption provided by H.R. 4167 would apply only to income from working interests in oil and gas wells received by pension trusts, IRAs, and schools. However, the rationale given for granting the exemption is that investment through a limited partnership is "passive" in nature and therefore should not be subject to the unrelated business income tax. This rational would apply equally to investments in any active business by any tax-exempt organization as long as the investment was made through a limited partnership. Therefore, adoption of this legislation would lead one to conclude that there should be a repeal of the unrelated business income tax for any investment made through a limited partnership. Such a repeal, however, would be inconsistent with the purpose for which the tax was enacted.

Placing an investment in an active business in a limited partnership does not eliminate the primary problem—unfair competition—to which the unrelated business income tax is directed. The competitive advantages available to a business owned by a tax-exempt entity arise from the fact that the tax-exempt owner does not pay tax on the income received from its equity investment in the business. While the degree to which the tax-exempt organization is involved in the active management of the business may affect whether the attention of the managers of the tax-exempt organization is diverted from exempt activities, it is not relevant to the issue of whether the business obtains a competitive advantage because of its tax-exempt ownership.

The exemption from the unrelated business income tax for rents, royalties, dividends, and interest was provided because, in addition to being "passive," investments producing these types of income had long been recognized as proper for educational and charitable organizations and because they did not appear likely to result in serious competition for taxable businesses having similar income. Thus, the "passive" nature of investments made through limited partnerships is not sufficient to justify an exemption from the unrelated business income tax.

Even if the "passive" nature of an investment were sufficient to justify exemption from the unrelated business income tax, limited partners are not necessarily "passive" investors. For example, under the 1976 Uniform Limited Partnership Act, a limited partner is permitted to engage in a number of activities relating to the operation of a business without being considered a general partner. These permitted activities include, among others, consulting with and advising a general partner with respect to the business of the limited partnership and voting on the removal of a general partner. Clearly, limited partners that can consult with and advise a general partner on business matters and can remove the general partner may have substantial active involvement in and control over the business of the limited partnership.

In addition to our objectives to providing a competitive advantage to an active business by allowing tax-exempt ownership through a limited partnership, we are concerned that partnership allocations may be used to transfer tax benefits from tax-exempt partners to taxable partners. We do not believe that the limitations on allocations contained in H.R. 4167 are sufficient to prevent such abuse. Rather, these limitations merely elevate the level of sophistication required to attain the desired results.

The allocation provisions of the bill contain certain technical deficiencies. For example, the bill does not require that allocations of basis be consistent with allocations of income or gain. Since the depletion with respect to an oil or gas property and gain or loss on the disposition of such property are computed at the partner level rather than the partnership level, allocation of basis to taxable partners may have the effect of allocating depletion deductions to taxable partners while allocating gain to tax-exempt partners. Similarly, the allocation rules in the bill do not prohibit the allocation of capital gain to the taxable partners and ordinary income to the tax-exempt partners, nor do they prevent distribution schemes under which tax-exempt partners receive property on which there is substantial unrealized gain while taxable partners receive property on which there is little or no unrealized gain.

In addition, the bill fails to preclude potential abuse through the use of partnership "flip-flops." Although the bill attempts to ensure that in each partnership taxable year the tax-exempt partner will be allocated no less a share of partnership loss, deduction, and credit than its share of partnership income and gain, it does not prevent the tax-exempt partner from having a disproportionately large share of all partnership items during partnership taxable years in which net taxable income is expected, and a disproportionately small share of all partnership items during partnership taxable years in which net losses are expected.

We also are concerned that investments by tax-exempt entities in limited partnerships engaged in active business may be used to benefit taxable persons in ways other than by the transfer of tax benefits. Participation in an active business provides numerous opportunities for subtle forms of self-dealing. For example, exploratory drilling conducted by a limited partnership on a tract of land can benefit owners of adjacent land. We see no justification for allowing tax-exempt income to be used to benefit taxable persons this way.

Finally, even if limited partnership interest in working interests in oil and gas wells were to be exempt from the tax on unrelated business income, we see no justification for exempting debt-financed investments in such property from the debt-financed property rules. As explained earlier, the debt-financed property rules were intended to prevent use of tax exemptions for the benefit of taxable persons. For several reasons, we do not believe the limitations on purchase price and financing provided in H.R. 4167 would prevent the abusive use of exemptions if debt-financed investments in working interests in oil and gas wells were not subject to the tax on unrelated business income.

One possibility for abuse exists because the restrictions on sale-leasebacks in the bill do not apply to sale-leasebacks between a limited partnership and a person related to the general partner. Thus, a tax-exempt organization could enter into a sale-leaseback with a taxable seller if the seller were a general partner and the terms of the sale and lease were consistent with the terms of similar transfers in the geographic area. While we recognize that the requirement that the terms be consistent with those of similar transfers in the geographic area is intended to prevent abuse, such a standard would be difficult and cumbersome, if not impossible, to administer effectively. Another possibility for benefit to a taxable person is that a tax-exempt organization may be willing to pay a higher price for the property than a taxable investor would, particularly since it could obtain nonrecourse financing from the seller. In recognition of the potential abuses that exist with seller financing, the current exception to the debt-financed property rules for real estate acquisitions was amended by the Deficit Reduction Act of 1984 to prohibit all seller financing. Finally, we are concerned that debt-financing would provide additional tax benefits that might be allocated unequally between taxable partners.

For the reasons described above, we oppose H.R. 4167.

H.R. 4507

ALLOWANCE OF INVESTMENT TAX CREDIT TO MEMBERS OF SECTION 501(d) ORGANIZATIONS

Current law

Section 501(d) of the Code provides an exemption from taxation for religious or apostolic associations or corporations if such organizations have a common or community treasury. The exemption is available only if the members of the organizations include in their gross income their entire pro rata shares, whether distributed or not, of the taxable income of the organization. Any amount so included in a member's gross income is treated as a dividend. Typically, these associations or corporations engage in a commercial enterprise, such as farming, for the common benefit of the members.

Prior to the enactment of section 501(d) these organizations did not qualify for tax exemption under the general rules for religious organizations because of the presence of commercial activities and private inurement. The income of the organizations was subject to the corporate income tax and was also subject to the individual income tax if distributed to members. If the organization's income was not distributed to members, it was subject to the accumulated earnings tax. The legislative history of section 501(d) indicates that the single tier of tax at the member level was intended to provide relief from the accumulated earnings tax.

Section 38(a) of the Code allows an investment tax credit for investment in certain depreciable property ("section 38 property"). The credit generally is ten percent of the taxpayer's qualified investment in section 38 property. The amount of credit allowable for any taxable year with respect to any taxpayer is limited. Any excess of credit over the limit may generally be carried back to the preceding three taxable years and forward to the following fifteen years.

Some or all of the investment tax credit taken by a taxpayer with respect to a particular piece of section 38 property is "recaptured" if such property is disposed of or ceases to be section 38 property in the hands of the taxpayer before the expiration of a specified period. In the year of recapture, the taxpayer's tax is increased by the portion of the credit recaptured. However, such tax is not increased if the credit was not used to reduce the taxpayer's tax in a prior year; in that case, the credit carryforward would be reduced.

Under section 48(a)(4), property used by an exempt organization does not qualify for the investment tax credit unless the property is used in a trade or business that is subject to the unrelated business income tax. Since section 501(d) organizations are not subject to the tax on unrelated business income, the investment tax credit is not allowable with respect to the property acquired by such organizations.

Description of H.R. 4507

For purposes of determining eligibility for the investment tax credit, H.R. 4507 would treat a business engaged in by an eligible section 501(d) organization as an unrelated trade or business. The qualified investment for each taxable year with respect to the business would be apportioned pro rata among the members in the same manner as the taxable income of the organization, and the members would be entitled to claim the investment tax credit with respect to their portion of the qualified investment. In addition, the credit under this amendment would not be allowable to individuals who claimed an investment tax credit without regard to this amendment.

The test for determining whether recapture is applicable would be applied at the entity level. Thus, recapture would be triggered only if the section 501(d) organization disposed of the property or the property ceased to be section 38 property in the hands of the organization. If recapture is applicable, the organization would be treated as if it had taken the credit which would have been allowed to it had the credit been available. The amount recaptured would not be affected by whether or not the credit was used to reduce tax in a prior year. Once the amount of recapture was determined, the total increase in tax would be allocated among the members in the manner that the organization's taxable income for such year is allocated.

An eligible section 501(d) organization would be an organization that elected to be treated as an organization described in section 501(d) and which either had been in existence for more than five years, or more than half the members of which had been members for more than five years of a section 501(d) organization or of a section 501(c)(3) religious community.

The bill would apply to periods after December 31, 1978, in taxable years ending after such date.

Discussion

The tax treatment of section 501(d) organizations is unique. In some ways, such organizations are treated like partnerships and S corporations. The primary similarity is that the income of a section 501(d) organization is subject to a single tier of tax at the number level. However, in other respects, the treatment of section 501(d) organizations differs significantly from that of partnerships or S corporations. For example, credits are not passed through to the members. Moreover, the income, deductions, gains, and losses of section 501(d) organizations do not retain their character when passed through to the members. Rather, the income is taxed to the members as a corporate dividend. As such, it is not subject to employment taxes. In addition, the section 501(d) rules regarding the allocation of income and loss and regarding the taxability of distributions differ from the rules governing partnerships of S corporations. When compared to the burden imposed on partnerships or S corporations, this unique tax treatment of section 501(d) organization can be beneficial in some cases and detrimental in others.

H.R. 4507 would allow the investment tax credit to pass through to the members of the section 501(d) organization. The argument in support of this proposal is that out of fairness section 501(d) organizations should be able to pass through the investment tax credit to their members as can be done by partnerships and S corporations. This argument on its own is not convincing, since, as noted, there are numerous differences between partnerships and S corporations, on the one hand, and section 501(d) organizations, on the other. The issue is better phrased as whether giving section 501(d) organizations this additional benefit could provide them a significant advantage over business operating in other forms. While there is no empirical evidence available on this question, section 501(d) organization always have the opportunity to operate as Subchapter C corporations, S corporations, or partnerships, but at least those pushing for this amendment have chosen not to do so. Moreover, if H.R. 4507 were to become law, we would anticipate future requests from section 501(d) organizations for legislation granting them more of the advantages of partnerships or S corporations without the additional restrictions. Such extension of pass-through concepts to section 501(d) organizations goes far beyond the purpose of section 501(d). Section 501(d) was a response to a limited problem, the accumulated earnings tax. It was not intended to create a new pass-through entity and we would oppose any efforts to create such an entity. For these reasons, Treasury opposes H.R. 4507.

Even if we favored permitting section 501(d) organizations to pass through the investment tax credit to their members, we would have serious concerns with the way in which H.R. 4507 attempts to accomplish this objective. Under H.R. 4507, the investment tax credit recapture provisions are applied solely at the entity level. Thus, for example, a member of a section 501(d) organization who had an excess credit as a member of the organization could leave the organization before the expiration of the recapture period and retain an unadjusted credit carryforward. This is in contrast to the basic rule, observed in every other context, that the determination of whether recapture is appropriate is made with respect to the taxpayer who took the credit. The application of this general rule is most clearly illustrated in the context of partnerships or S corporations. Obviously, if either of these entities disposes of section 38 property prematurely, recapture is triggered. In addition, if a partner or an S corporation shareholder disposes of his interest in the entity before the expiration of the recapture period, then there is recapture with respect to that partner or shareholder. The rules are aimed at preventing any taxpayer from taking advantage of the full credit with respect to property held only briefly by that taxpayer.

We understand that most members who leave the section 501(d) organizations leave owning no assets and would not be able to pay a tax created by recapture. However, there is little reason to allow such members to take investment tax credit carryforwards with them. Thus, an appropriate rule for members of section 501(d) organizations might be to apply recapture rules similar to those applicable to partners and S corporation shareholders, but also to carve out an exception (which would not apply to credit carryforwards) for departing members who leave owning assets of relatively little value.

Finally, certain technical problems associated with H.R. 4507 would need to be addressed. One such problem arises with respect to qualified progress expenditures (generally, amounts paid for the construction of an asset prior to completion). As drafted, the bill would allow one member to claim the investment tax credit with respect to qualified progress expenditures, leave the organization without recapture, and have the other members of the organization claim the credit for the same amount after construction was complete. This double benefit is expressly prohibited in all other contexts. In addition, it may be necessary to clarify the application of the at-risk rules to section 501(d) organizations, and to develop rules—similar to those applicable to partnerships and S corporations—restricting the availability of the investment tax credit with respect to property leased to other entities by section 501(d) organizations.

H.R. 4779

EXEMPTION FROM THE WINDFALL PROFIT TAX TO CERTAIN EXCHANGES OF CRUDE OIL FOR RESIDUAL FUEL OIL

Current law

Under present law, the windfall profit tax is imposed on all crude oil removed from the premises unless specifically exempt by the statute. The term "removal from the premises" includes the use of the crude oil on the property or the conversion of the oil into a refined product before the oil is physically removed from the premises. However, oil returned to or used on the property from which it came, either by reinjection or through the powering of production processes or equipment, is not considered sold or removed from the premises. Thus, for example, no tax is imposed on the on-site use of oil to generate power for an artificial lift device, water flood project or a tertiary injection process. However, oil removed from the premises prior to its use, or oil used to power refining or manufacturing processes on the premises is taxed.

Description of H.R. 4779

H.R. 4779 creates a new category of oil exempt from the windfall profit tax called "exempt production oil". "Exempt production oil" is defined as the number of barrels of domestic crude oil that is removed from a property during a calendar quarter, which would be taxable crude oil (but for this provision), and which is exchanged solely for an equal number of barrels of residual fuel oil used by the producer in an enhanced recovery process with respect to such property during the quarter or next succeeding quarter. In order to prevent sheltering of higher taxed oil, exempt production oil is allocated among tiers of crude oil produced during the quarter on the basis of removal prices beginning with the highest of the prices received. In addition, no deduction for depletion is allowed for exempt production oil. This conforms to the income tax rule that applies to oil used on a lease and not sold. Finally, the exemption is allowed only to holders of working interests in the property.

Discussion

Treasury does not oppose adoption of H.R. 4779. We understand that before the enactment of the windfall profit tax it was the practice of oil producers in certain regions to provide heavy crude oil to refiners in exchange for equivalent amounts of residual fuel oil, which the producers would then use as fuel for enhanced recovery processes. This arrangement permitted the refiners to extract and market the lighter elements of the crude oil which otherwise would be lost if the crude oil was burned by the producer. These exchange arrangements were generally terminated when the windfall profit tax was enacted since producers were able to avoid the tax by using their crude oil directly as a fuel to power production equipment. However, refiners were deprived of a significant source of crude oil for their refinery operations.

The termination of exchange agreements between producers and refiners was an unintended product of the enactment of the windfall profit tax. H.R. 4779 would restore a beneficial industry practice. Furthermore, since, in the absence of this provision, producers would use their crude oil as a fuel on their property in an exempt use, granting an exemption for such crude oil when exchanged for residual fuel oil would not result in a revenue loss.

H.R. 5022

PERCENTAGE DEPLETION NOT ALLOWABLE FOR LEASE BONUSES AND ADVANCE ROYALTIES WITH RESPECT TO OIL AND GAS PROPERTIES

Current law

In 1975 Congress enacted Section 613A, which essentially repealed percentage depletion for oil and gas. An exception was retained for production by producers and income received by royalty owners, but only to the extent of a limited volume of average daily production during the taxable year. Thus, under current law, independent producers and royalty owners can claim percentage depletion with respect to an average of 1,000 barrels of daily production of oil and gas equivalent. Proposed Treasury regulations under section 613A took the position that the average daily production requirement of the statute precluded amounts received in the form of bonus or advance royalties from qualifying for percentage depletion where there was no production in the year the bonus or advance royalty was received. However, in *Commissioner* v. *Engle*, 104 S. Ct. 597 (1984),, the Supreme Court held that the adoption of the production limitation by Congress in 1975 did not indicate an intent on the part of Congress to terminate percentage depletion for bonuses and advance royalties, even in the absence of production in the year of payment.

Following the Supreme Court's action, the Service announced that lessors of oil and gas properties who receive bonuses or advance royalties generally will be allowed to deduct percentage depletion on those amounts in the year the amounts are includible in gross income. However, in order to meet the production limits of section 613A, lessors must convert bonuses or advance royalties to barrels of production. This conversion is to be based on the representative market or field price. This rule applies to lease bonuses and advance royalties includible in income after December 31, 1974.

Description of H.R. 5022

H.R. 5022 would override the Supreme Court's *Engle* decision with respect to bonuses and advance royalties paid on or after January 1, 1984.

Discussion

A lease bonus represents cash consideration paid by a lessee for the execution of an oil and gas lease by a landowner. An advance royalty differs from a bonus in that it is a pre-payment of the landowner's share of anticipated production. In *Burnet* v. *Harmel*, 287 U.S. 193 (1932), the Supreme Court held that a bonus payment is not taxable as proceeds from the sale of a capital asset, but rather is ordinary income attributable to the mineral property. Furthermore, the court held that the landowner was entitled to a depletion deduction in the year of receipt even though there was no production in that year because the bonus was attributable to anticipated production. The *Burnet* v. *Harmel* rule was extended to percentage depletion for bonuses and advance royalties in the case of *Herring* v. *Commissioner*, 293 U.S. 322 (1934).

As a matter of proper tax accounting, the allowance of a depletion deduction for anticipated depletion of a mineral deposit is questionable. While the landowner receives an unconditional payment from the lessee in the form of a bonus and, accordingly, should be taxed on that amount, he does not suffer any depletion of his mineral interest. The more appropriate tax rule would allow recovery of the landowner's basis in the property through a depletion deduction only when and as production occurs. Thus, Treasury Department agrees with the approach taken in H.R. 5022.

Nevertheless, in 1975 Congress determined that the availability of percentage depletion should continue to a limited extent for independent producers and royalty owners. The position adopted by the Service subsequent to the *Engle* decision represents a reasonable interpretation of section 613A. In evaluating H.R. 5022 Congress must reconsider the need for extending percentage depletion, even to a limited extent, to advance royalties and bonus payments.

H.R. 5199

APPLICABILITY OF FARM SYNDICATE RULES OF SECTION 278(b) TO INEDIBLE FRUITS AND NUTS

Current law

In general, under section 278(b), a farming syndicate that is engage in planting, cultivating, maintaining, or developing a grove, orchard, or vineyard in which fruit or nuts are grown is required to capitalize any amount that is attributable to that activity and that is incurred in a taxable year prior to the first taxable year in which the grove, orchard, or vineyard bears a crop or yield in commercial quantities.

The IRS recently published proposed regulations under section 278(b) that interpret that section as applying to synidates that cultivate jojobas. The proposed regulations provide that, for purposes of section 278(b):

"A grove, orchard, or vineyard in which fruit or nuts are grown includes any group of trees, bushes, shrubs, or vines which produce a crop or yield of fruits or nuts. For purposes of this section, a "fruit" is defined as a fertilized and developed ovary of a plant, including the seeds, or, in the case of a plant that does not bear seeds, the fertile structure of the plant, and a "nut" is defined as a hard-shelled fruit. For example, fruits or nuts include apples, avocados, coffee beans, grapes, jojoba beans or seeds, pecans, pistachios and walnuts. (Prop. Reg. section 1.278-2(a)(2)).

Certain taxpayers have taken the position that the jojoba bean is not a "fruit or nut" because the bean is not edible, and that a tract of jojoba plants is not a "grove, orchard, or vineyard" because those terms generally refer to tracts of trees or vines, and the jojoba plant is not commonly considered a tree or vine. (According to "Webster's New Collegiate Dictionary" (1984), "jojoba" is defined as: "a shrub or small tree of the box family of southwestern No. America with edible seeds that yield a valuable liquid wax.")

Description of H.R. 5199

H.R. 5199 would amend section 278(b) to clarify that the provisions of that section apply to any farming syndicate engaged in planting, cultivating, maintaining, or developing a grove, orchard, vineyard, or other tract of trees, bushes, shrubs, or vines in which fruit or nuts (whether or not edible) are grown.

Discussion

Section 278(b) was added to the Code in 1976 because Congress intended that a farming syndicate conducting activities that result in the creation of long-lived crop-bearing or yield-bearing plants should not be entitled to deduct the costs of developing such plants to maturity in advance of the generation of income from such plants. Senate Report No. 94-938 (94th Cong., 2d Sess.), describing the tax rules underlying farming-related tax shelters prior to the enactment of section 278(b), explained that:

"Capital gain treatment is generally available on the sale of depreciable assets used in farming (as well as on the sale of the underlying farmland itself), even though these assets or land may have been developed or improved by expenditures which were deducted against ordinary income. In effect, a farm investor's income which is initially sheltered by accelerated farm deductions is transformed into added capital value of the farm asset and taxed as part of that value when the farm capital assets (vineyard, breeding animal, farmland, etc.) are later sold. . . . Generally, in farming operations tax losses can be shown in early years of an investment because of (1) the opportunity to deduct, when paid, costs which is nonfarm businesses would be inventoried and deducted in a later year, [and] (2) the ability to deduct, when paid, costs which should properly be capitalized. . . . The time value of deferring taxes on nonfarm income remains a strong attraction for outside investors to invest in farming and to use as much borrowed money as possible to create farm "tax loses." . . . The committee believes that the special farm tax rules should be severely curtailed for farming syndicates in which a substantial portion of the interest is held by taxpayers who are motivated, in very large part, by a desire to shelter other income, rather than by a desire to make a profit in the particular farming operation." (*Id.*, at 52-58.)

Because jojoba beans were not produced in substantial quantities in 1976, the drafters of section 278(b) did not specifically consider whether the provision should apply to syndicates that cultivate jojobas. However, the legislative history of section 278(b) demonstrates that section to be an application of general tax accounting rules that require the cost of developing long-lived assets (such as jojoba plants) to be capitalized and cost recovery deductions to be claimed only after the asset begins producing income.

We believe that the amendment to section 278(b) proposed by H.R. 5199 is a correct statement of what is already the law, namely, that a farming syndicate engaged in the planting, cultivation, maintenance, or development of a tract of jojoba plants is required by section 278(b) to capitalize the costs of such activity for years preceding the first taxable year in which such tract bears a crop or yield in commercial quantities. Nonetheless, since some taxpayers take a contrary position, we support this clarifying amendment, on the ground that it would resolve any dispute over the application of section 278(b) to jojoba investments made after the effective date of the amendment. Moreover, the rule stated in the amendment is correct—there is no good reason to treat jojobas differently from other long-lived plants for tax purposes.

Chairman STARK. Thank you very much, Mike.

On 5022, let me be sure I understand your statement. You have issued or are about to issue regulations that you feel may take care of the bonus problem?

Mr. ROLLYSON. We had regulations in the past which did not—which denied the percentage depletion to advanced royalties bonuses. The Supreme Court said the percentage depletion was available in those cases, reversing the position that we took in our regulations.

Since that decision, we issued an announcement which gives a different interpretation to section 613A which permits the percentage depletion to be taken in those cases in a manner that is consistent with the Supreme Court's decision. We do not have pending regulations on that.

Chairman STARK. So you are—you do favor the legislation—I am confused—you favor it, but you would like to see it in different form?

Mr. ROLLYSON. We agree with the approach in the legislation. As a conceptual matter, we don't think the percentage depletion should be available in these cases.

Chairman STARK. I thought maybe you were indicating your regulations had taken care of the problem, but that is not the case.

Mr. ROLLYSON. Right.

Chairman STARK. Thank you.

Our next witness is Mr. James Stafford, executive director of the National Association of Royalty Owners, Inc.

Mr. STAFFORD. Thank you, Mr. Chairman.

Chairman STARK. Welcome to the committee, Mr. Stafford. Your complete testimony, along with the attached tables and addendum, will be made a part of the record, and I would ask if you would like to summarize or supplement your testimony in the five minutes we have allotted to you. When the gong goes off, you may proceed in any manner you wish.

STATEMENT OF JAMES L. STAFFORD, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF ROYALTY OWNERS, INC.

Mr. STAFFORD. Our organization represents the small royalty owner, some 4,000 in 50 states and an additional 38,000 members that are affiliated with State and regional groups scattered around the Nation. Most of them are elderly, or nearing retirement, and that parallels with the pattern of surface ownership in the United States.

I am not going to comment on the *Engle* decision, I am not an attorney. I would like to explain briefly, though, some of the circumstances that cause us some concern and our reason for being here.

The terms, lease bonus and advanced royalty, are used rather loosely in practice. If we could rewrite a book on oil field terms, the words option to drill would come closest to being correct. That, in effect, is the money paid up front to reserve the right to enter upon the land and to drill and produce oil or gas.

We believe the depletion allowance on so-called lease bonuses has a valid purpose. I had prepared a comparison between the two option transactions. One, on the surface rights of land and the other on a lease bonus consideration for mineral rights for the same number of years. This was prepared on a single tract of land by CPA's in Lubbock, TX, by one of the few firms in the Nation specializing in mineral owner transactions.

You will notice from the comparisons that we have used $50,000 and $100,000 transactions as a matter of simplicity. Both of the figures are considerably higher than the average lease bonus transactions. You will note that a person is much better off in entering into a surface option situation for the amount of $50,000, because the mineral owner pays four times more in taxes than does the surface owner.

Recent surveys done for us by both Getty and Phillips show an average of 14 royalty owners per lease. This translates into about four royalty owners per well in most of this Nation. So anytime we are talking about a lease bonus, that has to be fragmented many times, for instance, on a 160-acre tract.

The problem in our area is that each time there is an attempt made to penalize either the energy industry or upscale royalty owners, the little folks get hit the hardest, so we are apprehensive.

Several other things are pertinent to these examples that we have in the attachments. One is that the lease bonus in the majority of cases is the only money the mineral owner will get from his asset. Geology is still far from a perfect science, and drilling for oil is still flying by the seat of the pants. When you do get a dry hole, more often than not it results in total condemnation of the mineral property. I have listed in my testimony a personal example that happened to me just this summer.

The lease bonus should be evaluated as an integral part of the lease negotiating process. In the actual day-to-day warfare between the lessor and the lessee, adjustments are made at the front end in the terms of the lease. So the lower lease bonus you get, usually the higher royalty you would attempt to negotiate.

It should be noted that we don't treat mineral interests like a trinket found in the attic. They are solid retirement vehicles, akin to a blue-collar stock market. We have been treated too many times like the "Beverly Hillbillies," or J.R. Ewing. J.R. is a producer, not a royalty owner.

The lease bonuses have been applied a great deal to subsidize farm-ranch operations. As you know, we are suffering an enormous drought in a great deal of the oil-producing States. I have attached for further clarification—because I think critics of the process may think that there is a great deal of income being earned on these lease bonuses—data from a petroleum land firm of Denver that monitors lease bonuses on a county basis. They are fairly accurate for almost every county of the Nation, including not only the States where lease bonuses are traditionally higher, such as Alabama, Mississippi, and Louisiana, but also, in States people don't consider to be oil States, such as New York, New Jersey, where there is drilling in Sussex County, Tennessee, Maryland, Michigan, North Dakota, and California.

As I said, these States are often overlooked as part of the oil patch. I appreciate greatly the opportunity to appear today, and we stand willing and ready to help in any way possible, Mr. Chairman.

Chairman STARK. Thank you very much.

[The prepared statement follows:]

JAMES L. STAFFORD, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION OF ROYALTY OWNERS, INC.

I'm Jim Stafford and I am Executive Director of the National Association of Royalty Owners, Inc., which is based in Ada, Oklahoma.

Our organization represents over 4000 small royalty owners in 50 states an an additional 38,000 members who have joined with our affiliated state, regional, and county mineral and royalty owner groups. Our members are neither largely retired, or nearing retirement, either living in rural areas, or on farms and ranches, and dependent upon royalty income for survival. (This age coincides with the actual characteristics of the nation's over 2 million royalty owners, which parallel to some extent surface owner demographics.)

Up front, I would respectfully like to comment that I am no lawyer and therefore will not quarrel with the Engle decision on this matter. Instead, I want to explain, with examples, what happens in the real world of oil and gas leasing.

First, the terms "lease bonus" and "advance royalty" are used rather loosely in the field to mean the same thing. If I could rewrite a book of oil field terms, the word "option to drill" would come closest to being correct.

It is, in effect, the money paid up front to reserve the right to enter upon the land and to drill and produce oil and gas. This contract or lease is between the lessee and the lessor, who I represent.

Our members believe the depletion allowance on so-called lease bonuses to be a valid and legitimate measure. I have had prepared a comparison between a two-year option transaction on a tract of land and a lease bonus consideration for mineral rights for the same number of years. It was prepared on a tract of property for simplicitly of comparison by Mary Badgett, a CPA in Lubbock, Texas, one of the few in the nation specializing in taxation of the mineral and royalty owner. Our comparisons are for two sums of money—$50,000 and $100,000—both are considerably larger than the average lease bonus transaction.

It should be noted that surveys taken for NARO by Getty and Phillips show there are an average of 14 royalty owners per lease. This translates into over four royalty owners per well in most of the nation. That means the typical lease bonus would likely be fragmented many times on a 160 acre mineral tract in any older producing area where mineral properties are commonly traded, sold, and bartered, aside from being split by deaths and estate divisions. It also should be noted that the average bonus in the United States may be much lower than commonly perceived, as will be discussed later.

My appearance here today is to clarify several facts that we feel need telling. It seems that each time an attempt is made to penalize the energy industry or the upscale royalty owners, it is the little folks who get hit hardest. (An Eason Oil Company survey of 7,000 royalty owners in 1980 proved less than 1 percent had income equal to a U.S. Congressman.)

To fully explain our attached financial examples, it should be further noted:

The lease bonus, in a majority of the cases, is the only money the mineral owner will ever get from his asset. Geology is still a far from perfect science and drilling for oil is still highly flying by the seat of your pants. (Only 16.7 percent of wildcat wells were successful in 1983, and only 42.4 percent of exploratory wells in or near proven fields—which are the areas where bonuses would apply.) "Close-in areas" are most likely "held by production" and thus not open to lease.

A dry hole usually results in absolute condemnation of the mineral property. (In June of this year I could have sold a 200-plus acre mineral tract owned in Coal County, Oklahoma, for $50,000. On August 16, a well was unsuccessfully completed on this tract. It is now worth absolutely nothing. It will never again be leased, never again be drilled. The only gain I ever received from this property was a lease bonus of $50 an acre. Taxes were paid for almost 30 years to hold this property.)

Rather than a "bonus", the money paid up front more closely resembles an option to drill. That's why we have shown that by comparison to a surface option, the lease preferential manner.

The lease bonus is an integral part of the lease negotiation process. The balance between a bonus and the royalty given is an important stage of that delicate process (the less bonus, the better lease provisions, and fractionally higher royalty). It should be noted that in the 30 plus oil states, we don't treat minerals like an overlooked trinket found in the attic. They are a solid, but highly risky, trading and retirement vehicle, akin to a farmer's pension fund or a blue-collar stock market.

The above statements are in defense of the royalty owner who has been portrayed for a century as either a Beverly Hillbilly or J.R. Ewing by the media who knows little of the process. Mr. Ewing, it should be noted, is an independent producer.

It should also be noted that many mineral interests have been traded off by drought-stricken farmer and ranchers over the years. It has been more of a survivial instrument than a bonanza.

To the farmer or rancher, exploration and drilling is not always a welcome event. It can result in acres of land being temporarily or permanently taken from fruitful production of growing crops or pasture. Salt water seepage, even under prudent practices, can condemn dozens of adjacent acres to oil drilling and operating areas.

It should further be noted that there are far more mineral owners of subsurface interests than surface interests in the old producing states.

Critics of fair tax treatment for lease bonuses should be aware that for the 1% royalty owners (those with incomes above $65,000 and with additional unleased holdings) much is plowed back into the oil business. The prime source of drilling fund money for small operators (who drill over 80% of the wells) since the turn of the century has been the royalty owner. His lower-rung cousin, according to NARO studies, is more likely to use lease bonus money for (1) payment of debt, (2) home or farmstead improvements, (3) purchase of additional land, and (4) retirement investments.

In closing, the current tax laws require the mineral owner to declare income in the year received, thus imposing the highest tax rate on the bonus income. The depletion deduction helps ease this burden.

When the lease lapses without production, the deduction becomes a deferred tax payment.

Without the lease bonus depletion consideration, mineral owners would most likely hold out for a higher royalty interest, thereby reducing returns to the producer for future exploration.

I have also attached lease terms data from the only such source in the nation, Petroleum Land Data, Inc. of Denver.

You will note that aside from Alabama, Mississippi, and Louisiana, the usual price per acre paid as bonus is more likely to be in the $1 to $10 range than the $100 and up ranges that make the pages of our nation's newspapers.

Every country in the nation where there is current activity is covered including New York, Virginia, New Jersey (Sussex), Tennessee, Maryland, Michigan, North Dakota, and other states often overlooked as being a part of the oil patch.

Mr. Chairman, I appreciate greatly the opportunity to appear here today on behalf of the nation's royalty owners. We at NARO stand ready and willing to help in any way possible.

SIDE-BY-SIDE COMPARISON OF SURFACE OWNER AND MINERAL OWNER

	Surface owner	Mineral owner
Assumption	Mr. Surface is interested in selling his land to a prospective purchaser.	Mr. Minerals would like to lease his mineral rights with the hope of future oil or gas production.
Initial cash received	Mr. Surface sells a 2-year option on his land. The option money he receives is his to keep, regardless of what the prospective purchaser may ultimately do.	Mr. Minerals signs a 2-yr oil and gas lease in exchange for a lease bonus. This money belongs to Mr. Minerals, whether the oil company drills or lets the lease lapse.
Tax reporting of income (timing)	Mr. Surface does not have to report his option money as income until the option is surrendered, terminated, or exercised.	Mr. Minerals must report his lease bonus as income during the year he receives the cash.
Type of income reported	If the option period is greater than 1 yr and the asset covered by the option is subject to capital gains, e.g., land, the gain will qualify as long-term capital gain. Only 40 percent of Mr. Surface's option money will be subject to tax.	The lease bonus is considered ordinary income, with the only deduction being a 15 percent statutory depletion. Thus, 85 percent of Mr. Minerals' lease bonus will be subject to tax. (Note: The oil company making the payment cannot deduct it, but must capitalize it instead, subject to writeoff against future oil income received.)
2 yrs later—option and lease both lapse.	Mr. Surface finally reports as income the money he received 2 yr ago. Additionally, he receives the preferential long-term capital gains treatment on that income.	Mr. Minerals must report as income the amount he previously deducted as percentage depletion. This income is taxed at the higher ordinary income tax rate.
2 yrs later—option and lease are exercised.	Assuming the option is exercised, the amount of the option payment will be considered part of the total sales price received for the land sold. Mr. Surface will report all of his gain as long-term capital gain.	A. If oil or gas is found, Mr. Minerals will be entitled to approximately 20 percent of the production. He has, in fact, "sold" the other 80 percent to the oil company. Although he "sold" his asset, (just as Mr. Surface did), he did not receive equal tax treatment. Furthermore, Mr. Minerals must report all subsequent royalty income as ordinary income. And once a barrel of oil or MCF of gas is removed, it will never be replaced. Mr. Minerals' asset is gone forever. B. If oil or gas is not found, not only does Mr. Minerals receive no further cash, but he must report as income the amount he previously reported as a deduction for percentage depletion. He also has little or no chance of ever leasing that property again.

	Surface owner		Minerals owner	
Income tax effects (assuming married, filing joint return, and no other income)				
EXAMPLE 1				
Cash received Oct. 1, 1984		$50,000		$50,000
Income taxes paid				
1984	0		$8,031	
1985	0		0	
1986	2,106		234	
Total tax paid		(2,106)		(8,265)
After-tax cash		47,894		41,735
EXAMPLE 2				
Cash received Oct. 1, 1984		100,000		100,000
Income taxes paid				
1984	0		24,828	
1985	0		0	
1986	12,000		1,265	
Total tax paid		(12,000)		(26,093)
After-tax cash		88,000		73,907

	Surface owner	Minerals owner
Summary	In the first example ($50,000), not only did Mr. Surface pay considerably less in income taxes, but he had "free" use of his money throughout the 2-yr option period. In the second example ($100,000), despite the fact that Mr. Surface was subject to an alternative minimum tax of $4,794 (included in his $12,000 total tax), he still paid much less income tax than Mr. Minerals.	The majority of mineral interest owners are farmers and ranchers, or the descendents of farming and ranching families. There has typically been little or no opportunity for these individuals to plan for retirement. Those who are still actively farming and ranching are suffering due to drought conditions and depressed prices for commodities. These people are using lease bonus funds in order to subsidize their farming and ranching operations.

```
                                                EXAMPLE I
                                                                        PAGE 1
   TAX PROJECTION  FOR INDIVIDUAL WHO RECEIVES LEASE BONUS
   DATE RECEIVED SEPTEMBER 29, 1984

   FEDERAL INCOME TAX SUMMARY
   --------------------------
   BASE YEAR IS 1984                  PERIOD          PERIOD          PERIOD
                                        1984            1985            1986

   FILING STATUS                       JOINT           JOINT           JOINT
   NUMBER OF EXEMPTIONS                    2               2               2
   WAGES, SALARIES                         0               0               0
   INTEREST AND DIVIDENDS                  0               0               0
   BUSINESS INCOME/LOSS                    0               0               0
   CAPITAL GAIN/LOSS                       0               0               0
   PARTNERSHIP INCOME/LOSS                 0               0               0
   OTHER INCOME/LOSS (S/A)            42,500               0           7,500
                                 -----------     -----------     -----------
   GROSS INCOME                       42,500               0           7,500
   ADJUSTMENTS TO INCOME                   0               0               0
                                 -----------     -----------     -----------
   ADJUSTED GROSS INCOME              42,500               0           7,500

   DEDUCTIONS :
    MEDICAL/DENTAL EXPENSES                0               0               0
    STATE & LOCAL INC TAXES                0               0               0
    OTHER TAXES                            0               0               0
    INTEREST EXPENSE                       0               0               0
    CHARITABLE CONTRIBUTIONS               0               0               0
    CASUALTY/THEFT LOSS                    0               0               0
    MISCELLANEOUS                          0               0               0
                                 -----------     -----------     -----------
    TOTAL DEDUCTIONS                       0               0               0
   ZERO BRACKET AMOUNT                 3,400           3,400           3,400
                                 -----------     -----------     -----------
   EXCESS ITEM. DEDUCTIONS                 0               0               0

   SUBTOTAL                           42,500               0           7,500
   EXEMPTIONS                          2,000           2,000           2,000
                                 -----------     -----------     -----------
   TAXABLE INCOME                     40,500          -2,000           5,500
                                 -----------     -----------     -----------
   TAX - TAX TABLES/XYZ                8,071               0             234
   TAX - INCOME AVERAGING                  *               *               *
   TAX SELECTED                        8,071               0             234
   ADDITIONAL TAXES                        0               0               0
                                 -----------     -----------     -----------
   GROSS REGULAR TAX                   8,071               0             234
   CREDITS (S/A)                           0               0               0
                                 -----------     -----------     -----------
   NET REGULAR TAX                     8,071               0             234
   SELF-EMPLOYMENT TAX                     0               0               0
   MINIMUM TAX                             0               0               0
   ALTERNATIVE MINIMUM TAX                 0               0               0
   OTHER TAXES                             0               0               0
                                 -----------     -----------     -----------
   TOTAL TAX LIABILITY                 8,071               0             234
   FEDERAL PAYMENTS                        0               0               0
                                 -----------     -----------     -----------
   BALANCE DUE (REFUND)                8,071               0             234
   TAX BRACKET                            33               0              12

     * INFO NOT ENTERED      S/A-SCHEDULE ATTACHED
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                                                                PAGE 2
TAX PROJECTION  FOR INDIVIDUAL WHO RECEIVES LEASE BONUS
DATE RECEIVED SEPTEMBER 29, 1984

OTHER INCOME/LOSS
-----------------
BASE YEAR IS 1984                          PERIOD        PERIOD
                                             1984          1986

REFUNDS OF STATE INC TAX                        0             0
ALIMONY RECEIVED                                0             0
SUPPLEMENTAL GAINS/LOSSES                       0             0
PENSIONS AND ANNUITIES                          0             0
OTHER SCHEDULE E INCOME                    42,500         7,500
FARM INCOME                                     0             0
UNEMPLOYMENT COMPENSATION                       0             0
TAXABLE SOCIAL SECURITY                         0             0
OTHER INCOME/LOSS                               0             0
                                       ----------    ----------
    TOTAL                                  42,500         7,500
                                       ----------    ----------
```

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                                                                      PAGE 3
 TAX PROJECTION  FOR INDIVIDUAL WHO RECEIVES LEASE BONUS
 DATE RECEIVED SEPTEMBER 29, 1984

 ALTERNATIVE MINIMUM TAX
 -----------------------
 BASE YEAR IS 1984                    PERIOD       PERIOD       PERIOD
                                        1984         1985         1986

  1.ADJUSTED GROSS INCOME             42,500            0        7,500
  2.CAP GAIN DEDUCTION                     0            0            0
  3.OTHER TAX PREF ITEMS               7,500            0            0
  4.ADD LINES 1,2 & 3                 50,000            0        7,500
  5.ALLOWABLE ITEM DEDUCT                  0            0            0
  6.OTHER REDUCTIONS                       0            0            0
  7.EXEMPTION AMOUNT                  40,000       40,000       40,000
  8.ADD LINES 5,6 & 7                 40,000       40,000       40,000
                                  ----------   ----------   ----------
  9.ALT MIN TAX INC(4-8)              10,000            0            0
                                  ----------   ----------   ----------
 10.TAX ON LINE 9                      2,000            0            0
 11.NET TAX LIABILITY                  8,031            0            0
 12.MINIMUM TAX                            0            0            0
 13.ITC RECAPTURE                      **N/A        **N/A        **N/A
 14.ADD LINES 11,12 & 13               8,031            0            0
 15.LINE 10 LESS LINE 14                   0            0            0
 16.FOREIGN TAX CREDIT                     0            0            0
                                  ----------   ----------   ----------
 17.ALT MIN TAX(15-16)                     0            0            0
                                  ----------   ----------   ----------

   ** NOT APPLICABLE
```

```
                                                                          PAGE 4
TAX PROJECTION  FOR INDIVIDUAL WHO RECEIVES LEASE BONUS
DATE RECEIVED SEPTEMBER 29, 1984

     INPUT ITEM                               PROJECTION
     ----------                               ----------

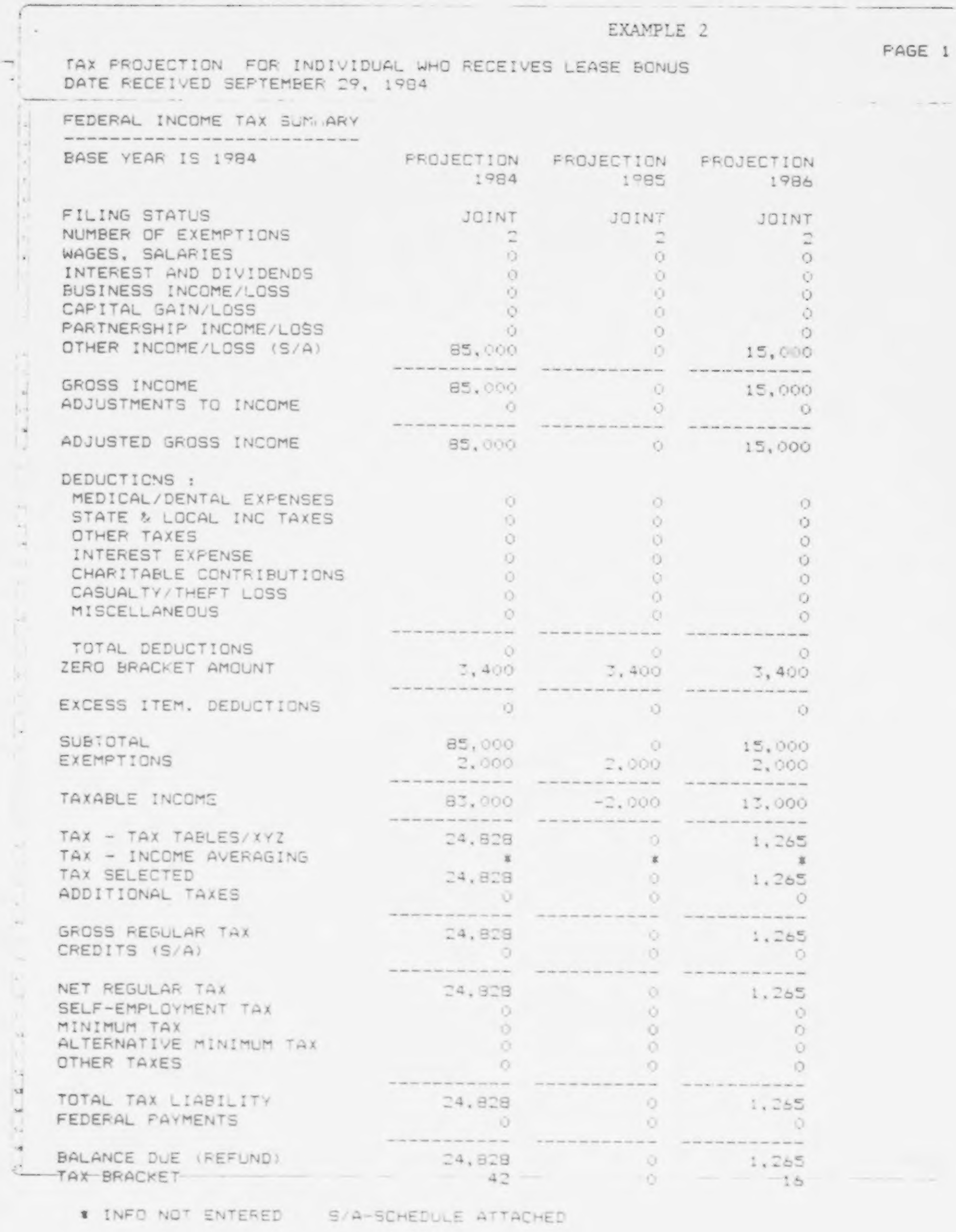
                                   1984          1985          1986
                                   ----          ----          ----

1.   FILING STATUS
                                      2

2.   EXEMPTIONS
                                      2             2             2

18.  OTHER SCHEDULE E INCOME/LOSS
       TAXPAYER                  42,500             0         7,500
       SPOUSE                         0             0             0

84.  TAX PREFERENCE ITEMS
       TAXPAYER                   7,500             0             0
       SPOUSE                         0             0             0
```



EXAMPLE 2

```
                                                                      PAGE 1
    TAX PROJECTION  FOR INDIVIDUAL WHO RECEIVES LEASE BONUS
    DATE RECEIVED SEPTEMBER 29, 1984

    FEDERAL INCOME TAX SUMMARY
    --------------------------
    BASE YEAR IS 1984             PROJECTION   PROJECTION   PROJECTION
                                        1984         1985         1986

    FILING STATUS                      JOINT        JOINT        JOINT
    NUMBER OF EXEMPTIONS                   2            2            2
    WAGES, SALARIES                        0            0            0
    INTEREST AND DIVIDENDS                 0            0            0
    BUSINESS INCOME/LOSS                   0            0            0
    CAPITAL GAIN/LOSS                      0            0            0
    PARTNERSHIP INCOME/LOSS                0            0            0
    OTHER INCOME/LOSS (S/A)           85,000            0       15,000
                                 -----------  -----------  -----------
    GROSS INCOME                      85,000            0       15,000
    ADJUSTMENTS TO INCOME                  0            0            0
                                 -----------  -----------  -----------
    ADJUSTED GROSS INCOME             85,000            0       15,000

    DEDUCTIONS :
     MEDICAL/DENTAL EXPENSES               0            0            0
     STATE & LOCAL INC TAXES               0            0            0
     OTHER TAXES                           0            0            0
     INTEREST EXPENSE                      0            0            0
     CHARITABLE CONTRIBUTIONS              0            0            0
     CASUALTY/THEFT LOSS                   0            0            0
     MISCELLANEOUS                         0            0            0
                                 -----------  -----------  -----------
     TOTAL DEDUCTIONS                      0            0            0
    ZERO BRACKET AMOUNT                3,400        3,400        3,400
                                 -----------  -----------  -----------
    EXCESS ITEM. DEDUCTIONS                0            0            0

    SUBTOTAL                          85,000            0       15,000
    EXEMPTIONS                         2,000        2,000        2,000
                                 -----------  -----------  -----------
    TAXABLE INCOME                    83,000       -2,000       13,000
                                 -----------  -----------  -----------
    TAX - TAX TABLES/XYZ              24,828            0        1,265
    TAX - INCOME AVERAGING                 *            *            *
    TAX SELECTED                      24,828            0        1,265
    ADDITIONAL TAXES                       0            0            0
                                 -----------  -----------  -----------
    GROSS REGULAR TAX                 24,828            0        1,265
    CREDITS (S/A)                          0            0            0
                                 -----------  -----------  -----------
    NET REGULAR TAX                   24,828            0        1,265
    SELF-EMPLOYMENT TAX                    0            0            0
    MINIMUM TAX                            0            0            0
    ALTERNATIVE MINIMUM TAX                0            0            0
    OTHER TAXES                            0            0            0
                                 -----------  -----------  -----------
    TOTAL TAX LIABILITY               24,828            0        1,265
    FEDERAL PAYMENTS                       0            0            0
                                 -----------  -----------  -----------
    BALANCE DUE (REFUND)              24,828            0        1,265
    TAX BRACKET                           42            0           16

      * INFO NOT ENTERED    S/A-SCHEDULE ATTACHED
```

```
                                                                  PAGE 2
   TAX PROJECTION  FOR INDIVIDUAL WHO RECEIVES LEASE BONUS
   DATE RECEIVED SEPTEMBER 29, 1984

   OTHER INCOME/LOSS
   -----------------
   BASE YEAR IS 1984              PROJECTION   PROJECTION
                                        1984         1986

   REFUNDS OF STATE INC TAX                0            0
   ALIMONY RECEIVED                        0            0
   SUPPLEMENTAL GAINS/LOSSES               0            0
   PENSIONS AND ANNUITIES                  0            0
   OTHER SCHEDULE E INCOME            85,000       15,000
   FARM INCOME                             0            0
   UNEMPLOYMENT COMPENSATION               0            0
   TAXABLE SOCIAL SECURITY                 0            0
   OTHER INCOME/LOSS                       0            0
                                 -----------  -----------
       TOTAL                          85,000       15,000
                                 -----------  -----------
```

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TAX PROJECTION  FOR INDIVIDUAL WHO RECEIVES LEASE BONUS
DATE RECEIVED SEPTEMBER 29, 1984

ALTERNATIVE MINIMUM TAX
-----------------------
BASE YEAR IS 1984                 PROJECTION  PROJECTION  PROJECTION
                                        1984        1985        1986

 1.ADJUSTED GROSS INCOME              85,000           0      15,000
 2.CAP GAIN DEDUCTION                      0           0           0
 3.OTHER TAX PREF ITEMS               15,000           0           0
 4.ADD LINES 1,2 & 3                 100,000           0      15,000
 5.ALLOWABLE ITEM DEDUCT                   0           0           0
 6.OTHER REDUCTIONS                        0           0           0
 7.EXEMPTION AMOUNT                   40,000      40,000      40,000
 8.ADD LINES 5,6 & 7                  40,000      40,000      40,000
                                 ----------- ----------- -----------
 9.ALT MIN TAX INC(4-8)               60,000           0           0
                                 ----------- ----------- -----------
10.TAX ON LINE 9                  [illegible]          0           0
11.NET TAX LIABILITY                  24,828           0           0
12.MINIMUM TAX                             0           0           0
13.ITC RECAPTURE                       **N/A       **N/A       **N/A
14.ADD LINES 11,12 & 13               24,828           0           0
15.LINE 10 LESS LINE 14                    0           0           0
16.FOREIGN TAX CREDIT                      0           0           0
                                 ----------- ----------- -----------
17.ALT MIN TAX(15-16)                      0           0           0
                                 ----------- ----------- -----------

  ** NOT APPLICABLE
```

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                                                                      PAGE 4
TAX PROJECTION  FOR INDIVIDUAL WHO RECEIVES LEASE BONUS
DATE RECEIVED SEPTEMBER 29, 1984

     INPUT ITEM                                PROJECTION
     ----------                                ----------

                                   1984        1985        1986
                                   ----        ----        ----

1.   FILING STATUS
                                      2

2.   EXEMPTIONS
                                      2           2           2

18.  OTHER SCHEDULE E INCOME/LOSS
       TAXPAYER                  85,000           0      15,000
       SPOUSE                         0           0           0

84.  TAX PREFERENCE ITEMS
       TAXPAYER                  15,000           0           0
       SPOUSE                         0           0           0
```

EXAMPLE 3

```
                                                                          PAGE 1
TAX PROJECTION FOR INDIVIDUAL WHO RECEIVES MONEY FOR OPTION TO PURCHASE
HIS LAND. OPTION FUNDS RECEIVED SEPTEMBER 29, 1984

FEDERAL INCOME TAX SUMMARY
--------------------------
BASE YEAR IS 1984                 PERIOD        PERIOD        PERIOD
                                    1984          1985          1986

FILING STATUS                      JOINT         JOINT         JOINT
NUMBER OF EXEMPTIONS                   2             2             2
WAGES, SALARIES                        0             0             0
INTEREST AND DIVIDENDS                 0             0             0
BUSINESS INCOME/LOSS                   0             0             0
CAPITAL GAIN/LOSS                      0             0        20,000
PARTNERSHIP INCOME/LOSS                0             0             0
OTHER INCOME/LOSS (S/A)                0             0             0
                             -----------   -----------   -----------
GROSS INCOME                           0             0        20,000
ADJUSTMENTS TO INCOME                  0             0             0
                             -----------   -----------   -----------
ADJUSTED GROSS INCOME                  0             0        20,000

DEDUCTIONS :
 MEDICAL/DENTAL EXPENSES               0             0             0
 STATE & LOCAL INC TAXES               0             0             0
 OTHER TAXES                           0             0             0
 INTEREST EXPENSE                      0             0             0
 CHARITABLE CONTRIBUTIONS              0             0             0
 CASUALTY/THEFT LOSS                   0             0             0
 MISCELLANEOUS                         0             0             0
                             -----------   -----------   -----------
 TOTAL DEDUCTIONS                      0             0             0
ZERO BRACKET AMOUNT                3,400         3,400         3,400
                             -----------   -----------   -----------
EXCESS ITEM. DEDUCTIONS                0             0             0

SUBTOTAL                               0             0        20,000
EXEMPTIONS                         2,000         2,000         2,000
                             -----------   -----------   -----------
TAXABLE INCOME                    -2,000        -2,000        18,000
                             -----------   -----------   -----------
TAX - TAX TABLES/XYZ                   0             0         2,106
TAX - INCOME AVERAGING                 *             *             *
TAX SELECTED                           0             0         2,106
ADDITIONAL TAXES                       0             0             0
                             -----------   -----------   -----------
GROSS REGULAR TAX                      0             0         2,106
CREDITS (S/A)                          0             0             0
                             -----------   -----------   -----------
NET REGULAR TAX                        0             0         2,106
SELF-EMPLOYMENT TAX                    0             0             0
MINIMUM TAX                            0             0             0
ALTERNATIVE MINIMUM TAX                0             0             0
OTHER TAXES                            0             0             0
                             -----------   -----------   -----------
TOTAL TAX LIABILITY                    0             0         2,106
FEDERAL PAYMENTS                       0             0             0
                             -----------   -----------   -----------
BALANCE DUE (REFUND)                   0             0         2,106
TAX BRACKET                            0             0            18

 * INFO NOT ENTERED
```

```
                                                                     PAGE 2
 TAX PROJECTION FOR INDIVIDUAL WHO RECEIVES MONEY FOR OPTION TO PURCHASE
 HIS LAND, OPTION FUNDS RECEIVED SEPTEMBER 29, 1984

 ALTERNATIVE MINIMUM TAX
 -----------------------
 BASE YEAR IS 1984                       PERIOD       PERIOD       PERIOD
                                           1984         1985         1986

  1.ADJUSTED GROSS INCOME                     0            0       20,000
  2.CAP GAIN DEDUCTION                        0            0       30,000
  3.OTHER TAX PREF ITEMS                      0            0            0
  4.ADD LINES 1,2 & 3                         0            0       50,000
  5.ALLOWABLE ITEM DEDUCT                     0            0            0
  6.OTHER REDUCTIONS                          0            0            0
  7.EXEMPTION AMOUNT                     40,000       40,000       40,000
  8.ADD LINES 5,6 & 7                    40,000       40,000       40,000
                                    ----------   ----------   ----------
  9.ALT MIN TAX INC(4-8)                      0            0       10,000
                                    ----------   ----------   ----------
 10.TAX ON LINE 9                             0            0        2,000
 11.NET TAX LIABILITY                         0            0        2,106
 12.MINIMUM TAX                               0            0            0
 13.ITC RECAPTURE                         **N/A        **N/A        **N/A
 14.ADD LINES 11,12 & 13                      0            0        2,106
 15.LINE 10 LESS LINE 14                      0            0            0
 16.FOREIGN TAX CREDIT                        0            0            0
                                    ----------   ----------   ----------
 17.ALT MIN TAX(15-16)                        0            0            0
                                    ----------   ----------   ----------

   ** NOT APPLICABLE
```

```
                                                                          PAGE 3
  TAX PROJECTION FOR INDIVIDUAL WHO RECEIVES MONEY FOR OPTION TO PURCHASE
  HIS LAND. OPTION FUNDS RECEIVED SEPTEMBER 29, 1984

        INPUT ITEM                            PROJECTION
        ----------                            ----------

                                   1984          1985          1986
                                   ----          ----          ----

  1.    FILING STATUS
                                      2

  2.    EXEMPTIONS
                                      2             2             2

  10.   LONG-TERM CAPITAL GAIN/LOSS
          TAXPAYER                    0             0        50,000
          SPOUSE                      0             0             0
```

EXAMPLE 4

PAGE 1

TAX PROJECTION FOR INDIVIDUAL WHO RECEIVES MONEY FOR OPTION TO PURCHASE
HIS LAND, OPTION FUNDS RECEIVED SEPTEMBER 29, 1984

FEDERAL INCOME TAX SUMMARY

BASE YEAR IS 1984	PERIOD 1984	PERIOD 1985	PERIOD 1986
FILING STATUS	JOINT	JOINT	JOINT
NUMBER OF EXEMPTIONS	2	2	2
WAGES, SALARIES	0	0	0
INTEREST AND DIVIDENDS	0	0	0
BUSINESS INCOME/LOSS	0	0	0
CAPITAL GAIN/LOSS	0	0	40,000
PARTNERSHIP INCOME/LOSS	0	0	0
OTHER INCOME/LOSS (S/A)	0	0	0
GROSS INCOME	0	0	40,000
ADJUSTMENTS TO INCOME	0	0	0
ADJUSTED GROSS INCOME	0	0	40,000
DEDUCTIONS :			
MEDICAL/DENTAL EXPENSES	0	0	0
STATE & LOCAL INC TAXES	0	0	0
OTHER TAXES	0	0	0
INTEREST EXPENSE	0	0	0
CHARITABLE CONTRIBUTIONS	0	0	0
CASUALTY/THEFT LOSS	0	0	0
MISCELLANEOUS	0	0	0
TOTAL DEDUCTIONS	0	0	0
ZERO BRACKET AMOUNT	3,400	3,400	3,400
EXCESS ITEM. DEDUCTIONS	0	0	0
SUBTOTAL	0	0	40,000
EXEMPTIONS	2,000	2,000	2,000
TAXABLE INCOME	-2,000	-2,000	38,000
TAX - TAX TABLES/XYZ	0	0	7,206
TAX - INCOME AVERAGING	*	*	*
TAX SELECTED	0	0	7,206
ADDITIONAL TAXES	0	0	0
GROSS REGULAR TAX	0	0	7,206
CREDITS (S/A)	0	0	0
NET REGULAR TAX	0	0	7,206
SELF-EMPLOYMENT TAX	0	0	0
MINIMUM TAX	0	0	0
ALTERNATIVE MINIMUM TAX	0	0	4,794
OTHER TAXES	0	0	0
TOTAL TAX LIABILITY	0	0	12,000
FEDERAL PAYMENTS	0	0	0
BALANCE DUE (REFUND)	0	0	12,000
TAX BRACKET	0	0	33

* INFO NOT ENTERED

```
                                                                              PAGE 2
   TAX PROJECTION FOR INDIVIDUAL WHO RECEIVES MONEY FOR OPTION TO PURCHASE
   HIS LAND, OPTION FUNDS RECEIVED SEPTEMBER 29, 1984

   ALTERNATIVE MINIMUM TAX
   -----------------------
   BASE YEAR IS 1984                       PERIOD       PERIOD       PERIOD
                                             1984         1985         1986

    1.ADJUSTED GROSS INCOME                     0            0       40,000
    2.CAP GAIN DEDUCTION                        0            0       60,000
    3.OTHER TAX PREF ITEMS                      0            0            0
    4.ADD LINES 1,2 & 3                         0            0      100,000
    5.ALLOWABLE ITEM DEDUCT                     0            0            0
    6.OTHER REDUCTIONS                          0            0            0
    7.EXEMPTION AMOUNT                     40,000       40,000       40,000
    8.ADD LINES 5,6 & 7                    40,000       40,000       40,000
                                      -----------  -----------  -----------
    9.ALT MIN TAX INC(4-8)                      0            0       60,000
                                      -----------  -----------  -----------
   10.TAX ON LINE 9                             0            0       12,000
   11.NET TAX LIABILITY                         0            0        7,206
   12.MINIMUM TAX                               0            0            0
   13.ITC RECAPTURE                        **N/A        **N/A        **N/A
   14.ADD LINES 11,12 & 13                      0            0        7,206
   15.LINE 10 LESS LINE 14                      0            0        4,794
   16.FOREIGN TAX CREDIT                        0            0            0
                                      -----------  -----------  -----------
   17.ALT MIN TAX(15-16)                        0            0        4,794
                                      -----------  -----------  -----------

    ** NOT APPLICABLE
```

```
                                                                            PAGE 3
   TAX PROJECTION FOR INDIVIDUAL WHO RECEIVES MONEY FOR OPTION TO PURCHASE
   HIS LAND, OPTION FUNDS RECEIVED SEPTEMBER 29, 1984

        INPUT ITEM                                PROJECTION
        ----------                                ----------

                                         1984          1985          1986
                                         ----          ----          ----

   1.   FILING STATUS
                                            2

   2.   EXEMPTIONS
                                            2             2             2

   10.  LONG-TERM CAPITAL GAIN/LOSS
          TAXPAYER                          0             0       100,000
          SPOUSE                            0             0             0
```

DATA FROM PETROLEUM LAND DATA, INC., DENVER CO ON LEASE BONUS PAYMENTS
August, 1984

**** REGION #1 SOUTHEAST ****

State	Sub.	County	Act	Bonus in $$ per Acre Low	High	Most Common	Royalty Range Low%	High%	Rental Range $/Acre/Yr Low	High	Lease Term Years Low	High
AL	C/3	BALDWIN	x	75.00	175.00	125.00	16.67	25.00	1.00	1.00	3.00	5.00
AL	NE/5	BALDWIN		150.00	350.00	350.00	16.67	20.00	1.00	1.00	3.00	5.00
AL	NW/5	BALDWIN	x	75.00	475.00	125.00	16.67	20.00	1.00	1.00	3.00	5.00
AL	S/3	BALDWIN	x	50.00	250.00	150.00	16.67	25.00	1.00	1.00	1.00	5.00
AL		BIBB		15.00	25.00	20.00	12.50	15.67	1.00	1.00	5.00	10.00
AL		CHEROKEE		10.00	15.00	15.00	12.50	16.67	1.00	1.00	5.00	10.00
AL		CHOCTAW		25.00	100.00	25.00	12.50	20.00	1.00	1.00	5.00	5.00
AL		CLARKE		25.00	100.00	75.00	12.50	18.75	1.00	1.00	5.00	10.00
AL		COLBERT		1.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
AL		CONECUH		25.00	50.00	25.00	12.50	18.75	1.00	1.00	5.00	10.00
AL		COVINGTON		10.00	75.00	35.00	12.50	20.00	1.00	1.00	5.00	5.00
AL		CULLMAN		3.00	15.00	5.00	12.50	12.50	1.00	1.00	5.00	5.00
AL	E/3	ESCAMBIA		25.00	150.00	75.00	12.50	20.00	1.00	1.00	3.00	5.00
AL	C/3	ESCAMBIA		100.00	350.00	150.00	18.75	25.00	1.00	1.00	3.00	5.00
AL	W/3	ESCAMBIA		200.00	1000.00	350.00	16.67	25.00	1.00	1.00	3.00	5.00
AL		ETOWAH		10.00	40.00	20.00	12.50	18.00	1.00	1.00	5.00	10.00
AL		FAYETTE		25.00	125.00	50.00	16.67	18.75	1.00	1.00	5.00	10.00
AL		FRANKLIN		1.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	5.00
AL		GREENE		30.00	55.00	30.00	12.50	15.67	1.00	1.00	5.00	10.00
AL		HALE		20.00	65.00	30.00	12.50	15.67	1.00	1.00	5.00	10.00
AL		JEFFERSON		10.00	25.00	15.00	12.50	16.67	1.00	1.00	5.00	10.00
AL		LAMAR		30.00	200.00	75.00	12.50	20.00	1.00	1.00	5.00	5.00
AL		LAWRENCE		1.00	5.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
AL		MARENGO		10.00	15.00	15.00	12.50	15.67	1.00	1.00	5.00	10.00
AL		MARION		5.00	40.00	10.00	12.50	18.75	1.00	1.00	5.00	5.00
AL	NE	MOBILE		150.00	800.00	300.00	16.67	25.00	1.00	1.00	3.00	5.00
AL	[illegible]	MOBILE		125.00	150.00	125.00	16.67	25.00	1.00	1.00	3.00	5.00
AL	[illegible]	MOBILE		100.00	500.00	175.00	16.67	25.00	1.00	1.00	3.00	5.00
AL	SW	MOBILE		125.00	750.00	250.00	16.67	25.00	1.00	1.00	3.00	5.00
AL		MONROE		50.00	175.00	75.00	12.50	25.00	1.00	1.00	5.00	10.00
AL		MORGAN		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
AL		PICKENS		10.00	100.00	75.00	12.50	20.00	1.00	1.00	5.00	5.00
AL		SHELBY		15.00	25.00	15.00	12.50	12.50	1.00	1.00	5.00	10.00
AL		ST. CLAIR		15.00	25.00	20.00	12.50	16.67	1.00	1.00	5.00	10.00
AL		SUMTER		25.00	75.00	50.00	12.50	18.75	1.00	1.00	5.00	10.00
AL		TUSCALOOSA		10.00	75.00	30.00	12.50	18.75	1.00	1.00	5.00	5.00
AL		WALKER		3.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	5.00
AL		WASHINGTON		50.00	125.00	90.00	12.50	18.75	1.00	1.00	5.00	5.00
AL		WINSTON		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		ASHLEY		25.00	75.00	35.00	12.50	18.75	1.00	1.00	3.00	5.00
AR		ARKANSAS		10.00	50.00	25.00	12.50	16.67	1.00	1.00	3.00	5.00
AR		BRADLEY		25.00	75.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
AR		CALHOUN		25.00	50.00	25.00	12.50	15.67	1.00	1.00	3.00	5.00
AR		CHICOT		10.00	25.00	25.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		CLARK		10.00	25.00	25.00	12.50	15.67	1.00	1.00	3.00	10.00
AR		CLEVELAND		10.00	25.00	20.00	12.50	12.50	1.00	1.00	3.00	5.00
AR		COLUMBIA		50.00	200.00 -	100.00	18.75	25.00	1.00	10.00	3.00	5.00
AR		DESHA		3.00	25.00	15.00	12.50	12.50	1.00	1.00	5.00	5.00
AR		DALLAS		10.00	25.00	25.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		DREW		10.00	25.00	20.00	12.50	15.67	1.00	1.00	5.00	10.00
AR		GRANT		10.00	25.00	20.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		HEMPSTEAD		10.00	25.00	25.00	12.50	15.67	1.00	1.00	5.00	10.00
AR		HOT SPRINGS		10.00	25.00	15.00	12.50	15.67	1.00	1.00	5.00	5.00
AR		HOWARD		10.00	25.00	25.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		JEFFERSON		3.00	25.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		LAFAYETTE		25.00	150.00	75.00	12.50	18.75	1.00	1.00	3.00	5.00
AR		LINCOLN		5.00	25.00	25.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		LITTLE RIVER		25.00	75.00	50.00	12.50	25.00	1.00	1.00	3.00	5.00
AR		MILLER		25.00	125.00	75.00	12.50	25.00	1.00	1.00	3.00	5.00
AR		MONTGOMERY		3.00	35.00	15.00	12.50	12.50	1.00	1.00	3.00	10.00
AR		NEVADA		25.00	75.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
AR		OUACHITA		25.00	75.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
AR		PIKE		5.00	20.00	10.00	12.50	12.50	1.00	1.00	3.00	5.00
AR		SEVIER		3.00	25.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		UNION	x	75.00	200.00	100.00	12.50	25.00	1.00	10.00	1.00	5.00
FL	S/2	ESCAMBIA		35.00	125.00	75.00	12.50	25.00	1.00	1.00	3.00	5.00
FL	N/2	ESCAMBIA		100.00	750.00	200.00	18.75	25.00	1.00	1.00	3.00	5.00
FL		OKALOOSA		15.00	75.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
FL	N/2	SANTA ROSA		50.00	450.00	250.00	18.75	25.00	1.00	1.00	3.00	5.00
FL	S/2	SANTA ROSA		25.00	150.00	75.00	18.75	25.00	1.00	1.00	3.00	5.00
FL		WALTON		15.00	75.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
LA		ACADIA		50.00	250.00	150.00	20.00	25.00	50.00	100.00	1.00	3.00
LA		ALLEN		35.00	125.00	50.00	16.67	25.00	50.00	100.00	3.00	5.00
LA		ASCENSION		150.00	150.00	100.00	16.67	25.00	100.00	150.00	3.00	5.00
LA		ASSUMPTION		100.00	150.00	100.00	16.67	25.00	100.00	150.00	3.00	5.00

**** REGION #1 SOUTHEAST cont'd ****

State	Sub.	County	Act	Bonus in $$ per Acre Low	Bonus in $$ per Acre High	Bonus in $$ per Acre Most Common	Royalty Range Low%	Royalty Range High%	Rental Range $/Acre/Yr Low	Rental Range $/Acre/Yr High	Lease Term Years Low	Lease Term Years High
LA		AVOYELLES		35.00	150.00	75.00	12.50	25.00	1.00	10.00	3.00	5.00
LA		BEAUREGARD		50.00	125.00	50.00	16.67	25.00	25.00	100.00	3.00	5.00
LA		BIENVILLE		75.00	150.00	100.00	12.50	25.00	1.00	2.00	3.00	5.00
LA		BOSSIER		50.00	150.00	100.00	12.50	25.00	1.00	2.00	3.00	5.00
LA		CADDO		75.00	400.00	100.00	12.50	25.00	1.00	2.00	0.50	5.00
LA		CALCASIEU		50.00	150.00	100.00	16.67	25.00	50.00	100.00	1.00	3.00
LA		CALDWELL		35.00	150.00	75.00	12.50	25.00	1.00	10.00	3.00	5.00
LA		CAMERON		100.00	300.00	150.00	20.00	30.00	50.00	150.00	1.00	3.00
LA		CATAHOULA		35.00	150.00	75.00	12.50	25.00	1.00	10.00	3.00	5.00
LA		CLAIBORNE		75.00	150.00	100.00	15.67	25.00	1.00	2.00	3.00	5.00
LA		CONCORDIA		35.00	150.00	75.00	12.50	25.00	1.00	10.00	3.00	5.00
LA		DE SOTO		75.00	125.00	100.00	12.50	18.75	1.00	2.00	0.50	5.00
LA		EAST BATON ROUGE	*x	100.00	750.00	150.00	16.67	30.00	100.00	500.00	3.00	5.00
LA		EAST CARROLL	-x	35.00	65.00	50.00	12.50	25.00	1.00	10.00	3.00	5.00
LA		EAST FELICIANA		100.00	300.00	100.00	15.67	25.00	25.00	150.00	3.00	5.00
LA		EVANGELINE		50.00	125.00	75.00	15.67	25.00	50.00	100.00	1.00	3.00
LA		FRANKLIN		35.00	150.00	75.00	12.50	25.00	1.00	10.00	3.00	5.00
LA		GRANT		35.00	75.00	50.00	12.50	18.75	1.00	5.00	3.00	5.00
LA		IBERVILLE		75.00	250.00	100.00	15.67	25.00	50.00	100.00	3.00	3.00
LA		JACKSON		75.00	250.00	100.00	15.67	25.00	1.00	2.00	3.00	5.00
LA		JEFFERSON DAVIS		50.00	200.00	125.00	16.67	25.00	50.00	100.00	3.00	3.00
LA		JEFFERSON	+x	150.00	500.00	150.00	16.67	25.00	100.00	150.00	3.00	3.00
LA		LAFAYETTE		100.00	250.00	125.00	15.67	25.00	100.00	150.00	3.00	3.00
LA		LAFOURCHE		150.00	500.00	200.00	15.67	30.00	100.00	200.00	3.00	3.00
LA		LASALLE		35.00	75.00	50.00	12.50	18.75	1.00	5.00	3.00	5.00
LA		LINCOLN		100.00	200.00	125.00	16.67	25.00	1.00	2.00	2.00	5.00
LA		LIVINGSTON		100.00	1000.00	300.00	16.67	25.00	100.00	[illegible]	3.00	5.00
LA		MADISON		25.00	75.00	50.00	12.50	18.75	1.00	5.00	3.00	5.00
LA		MOREHOUSE		25.00	75.00	50.00	12.50	18.75	1.00	5.00	3.00	5.00
LA		NATCHITOCHES		75.00	125.00	100.00	12.50	18.75	1.00	2.00	3.00	5.00
LA		ORLEANS		100.00	250.00	125.00	16.67	25.00	100.00	125.00	3.00	3.00
LA		OUACHITA		75.00	150.00	100.00	12.50	18.75	1.00	2.00	3.00	5.00
LA		PLAQUEMINES		150.00	350.00	175.00	15.67	25.00	100.00	150.00	3.00	5.00
LA		POINTE COUPEE		50.00	500.00	150.00	15.67	25.00	50.00	500.00	3.00	5.00
LA		RAPIDES		35.00	100.00	75.00	12.50	25.00	1.00	10.00	3.00	5.00
LA		RED RIVER		75.00	100.00	100.00	12.50	18.75	1.00	2.00	3.00	5.00
LA		RICHLAND		35.00	75.00	50.00	12.50	18.75	1.00	10.00	3.00	5.00
LA		SABINE		50.00	150.00	100.00	12.50	25.00	1.00	2.00	0.50	5.00
LA		ST BERNARD		100.00	250.00	150.00	15.67	25.00	100.00	200.00	3.00	5.00
LA		ST CHARLES		100.00	312.00	125.00	15.67	26.00	100.00	125.00	3.00	5.00
LA		ST HELENA	+x*	50.00	500.00	200.00	16.67	25.00	25.00	500.00	3.00	5.00
LA		ST JAMES		100.00	250.00	125.00	16.67	25.00	100.00	125.00	3.00	3.00
LA		ST JOHN BAPTIST		100.00	250.00	125.00	16.67	25.00	100.00	125.00	3.00	3.00
LA	N/2	ST LANDRY		100.00	300.00	125.00	16.67	25.00	75.00	150.00	3.00	5.00
LA	S/2	ST LANDRY		75.00	150.00	100.00	15.67	25.00	75.00	125.00	3.00	3.00
LA		ST MARTIN		100.00	250.00	125.00	16.67	25.00	50.00	100.00	3.00	3.00
LA		ST MARY		100.00	250.00	125.00	16.67	25.00	50.00	150.00	3.00	3.00
LA		ST TAMMANY		50.00	300.00	150.00	16.67	25.00	50.00	150.00	3.00	5.00
LA		TANGIPAHOA		50.00	400.00	100.00	16.67	25.00	20.00	200.00	3.00	5.00
LA		TENSAS		35.00	100.00	75.00	12.50	25.00	1.00	10.00	3.00	5.00
LA		TERREBONNE		100.00	500.00	150.00	16.67	30.00	50.00	150.00	3.00	3.00
LA		UNION		75.00	150.00	100.00	12.50	25.00	1.00	2.00	3.00	5.00
LA		VERMILION		75.00	500.00	150.00	16.67	25.00	75.00	200.00	3.00	3.00
LA		VERNON		25.00	75.00	50.00	12.50	18.75	1.00	2.00	3.00	5.00
LA		WASHINGTON	-x*	50.00	200.00	100.00	15.67	25.00	25.00	100.00	3.00	5.00
LA		WEBSTER		50.00	150.00	100.00	12.50	25.00	1.00	2.00	3.00	5.00
LA		WEST BATON ROUGE	-*	100.00	500.00	150.00	16.67	25.00	50.00	250.00	3.00	5.00
LA		WEST CARROLL	-x*	25.00	75.00	50.00	12.50	18.75	1.00	5.00	3.00	5.00
LA		WEST FELICIANA		150.00	400.00	150.00	16.67	25.00	75.00	200.00	3.00	5.00
LA		WINN		75.00	125.00	100.00	16.67	18.75	1.00	2.00	3.00	5.00
MS		ADAMS		50.00	175.00	125.00	16.67	18.75	1.00	1.00	3.00	8.00
MS		AMITE		100.00	200.00	100.00	16.67	25.00	1.00	1.00	3.00	5.00
MS		ATTALA		1.00	5.00	4.00	12.50	12.50	1.00	1.00	5.00	10.00
MS		BOLIVAR		25.00	50.00	35.00	12.50	18.75	1.00	1.00	5.00	10.00
MS		CALHOUN		10.00	50.00	20.00	12.50	18.75	1.00	1.00	3.00	5.00
MS		CARROLL		10.00	25.00	20.00	12.50	18.75	1.00	1.00	5.00	5.00
MS		CHICKASAW		10.00	50.00	20.00	12.50	18.75	1.00	1.00	3.00	5.00
MS		CLAIBORNE		50.00	150.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
MS		CLARKE		175.00	275.00	200.00	18.75	18.75	1.00	1.00	3.00	5.00
MS		CLAY		20.00	100.00	50.00	18.75	18.75	1.00	1.00	3.00	5.00
MS		COAHOMA		25.00	50.00	35.00	12.50	18.75	1.00	1.00	3.00	3.00
MS		COPIAH		50.00	150.00	100.00	12.50	12.50	1.00	1.00	3.00	5.00
MS		COVINGTON		100.00	250.00	200.00	12.50	18.75	1.00	1.00	3.00	5.00
MS		FORREST		90.00	150.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
MS		FRANKLIN		75.00	150.00	125.00	15.67	18.75	1.00	1.00	3.00	5.00

**** REGION #1 SOUTHEAST cont'd ****

State	Sub.	County	Act	* Bonus in $$ per Acre * Low	High	Most Common *	Royalty Range Low%	High%	Rental Range $/Acre/Yr Low	High	Lease Term Years Low	High
MS		GEORGE		75.00	150.00	125.00	25.00	18.75	1.00	1.00	3.00	5.00
MS		GREENE		[illegible]	150.00	125.00	[illegible]	[illegible]	1.00	1.00	[illegible]	5.00
MS		GRENADA		[illegible]	50.00	[illegible]	12.50	18.75	1.00	1.00	5.00	5.00
MS	N/2	HANCOCK		200.00	650.00	300.00	[illegible]	[illegible]	1.00	1.00	[illegible]	5.00
MS	S/2	HANCOCK		75.00	250.00	150.00	18.75	25.00	1.00	1.00	3.00	5.00
MS		HARRISON		50.00	150.00	100.00	16.67	25.00	1.00	1.00	3.00	5.00
MS		HINDS		50.00	150.00	100.00	12.50	[illegible]	1.00	1.00	5.00	5.00
MS		HOLMES		10.00	25.00	15.00	12.50	18.75	1.00	1.00	5.00	5.00
MS		HUMPHREYS		[illegible]	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
MS		ISSAQUENA		25.00	50.00	33.50	12.50	12.50	1.00	1.00	5.00	5.00
MS		ITAWAMBA		10.00	20.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
MS		JACKSON		50.00	150.00	100.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		[illegible]		175.00	275.00	200.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		JEFFERSON DAVIS		150.00	300.00	200.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		JEFFERSON		75.00	150.00	100.00	12.50	18.75	1.00	1.00	5.00	5.00
MS		LAFAYETTE		5.00	20.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
MS		LAMAR		[illegible]	150.00	100.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		LAWRENCE		200.00	300.00	250.00	[illegible]	25.00	1.00	1.00	[illegible]	[illegible]
MS		LE FLORE		2.00	10.00	5.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		LEE		5.00	20.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
MS		LINCOLN		100.00	200.00	100.00	16.67	25.00	1.00	1.00	3.00	5.00
MS		[illegible]	-0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		[illegible]		[illegible]	150.00	[illegible]	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		[illegible]		100.00	[illegible]	200.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		MONROE	-0	25.00	50.00	25.00	18.75	25.00	1.00	1.00	3.00	5.00
MS		MONTGOMERY		10.00	25.00	20.00	12.50	18.75	1.00	1.00	5.00	5.00
MS		NESHOBA		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		NEWTON		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		OKTIBBEHA		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS	N/2	PEARL RIVER		100.00	250.00	175.00	18.75	25.00	1.00	1.00	3.00	5.00
MS	S/2	PEARL RIVER		200.00	500.00	250.00	16.67	25.00	1.00	1.00	3.00	5.00
MS		PONTOTOC		10.00	50.00	20.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		[illegible]		25.00	125.00	50.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		RANKIN		100.00	250.00	200.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		SCOTT		50.00	150.00	75.00	12.50	25.00	1.00	1.00	3.00	5.00
MS		SHARKEY		10.00	20.00	15.00	12.50	12.50	1.00	1.00	5.00	5.00
MS		SIMPSON		100.00	[illegible]	150.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		[illegible]		[illegible]	150.00	100.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		[illegible]		[illegible]	150.00	125.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		SUNFLOWER		25.00	50.00	35.00	12.50	18.75	1.00	1.00	5.00	5.00
MS		TALLAHATCHIE		20.00	35.00	25.00	12.50	18.75	1.00	1.00	5.00	5.00
MS		[illegible]		[illegible]	20.00	10.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		WALTHALL		50.00	300.00	150.00	[illegible]	25.00	1.00	1.00	[illegible]	[illegible]
MS		[illegible]		[illegible]	200.00	150.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		WASHINGTON		1.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
MS		WEBSTER		15.00	75.00	40.00	12.50	18.75	1.00	1.00	3.00	5.00
MS		WILKINSON		100.00	150.00	100.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
MS		YAZOO		[illegible]	150.00	100.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
NC		ASHE		[illegible]	15.00	3.00	[illegible]	[illegible]	1.00	1.00	[illegible]	[illegible]
NC		CHEROKEE		3.00	3.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
NC		WATAUGA		3.00	15.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
TN		BLEDSOE		5.00	15.00	[illegible]	12.50	12.50	1.00	2.00	2.00	5.00
TN		GRAINGER		25.00	25.00	25.00	12.50	12.50	1.00	1.00	10.00	10.00
TN		GREENE		25.00	50.00	25.00	12.50	12.50	1.00	1.00	10.00	10.00
TN		GRUNDY		5.00	15.00	3.00	12.50	12.50	1.00	2.00	2.00	5.00
TN		HAWKINS		25.00	25.00	25.00	12.50	12.50	1.00	1.00	10.00	10.00
TN		MARION		5.00	15.00	[illegible]	12.50	12.50	1.00	2.00	2.00	5.00
TN		SEQUATCHIE		5.00	15.00	[illegible]	12.50	12.50	1.00	2.00	2.00	5.00
TN		SULLIVAN		25.00	35.00	25.00	12.50	12.50	1.00	1.00	10.00	10.00
TN		VAN BUREN		5.00	15.00	8.00	12.50	12.50	1.00	2.00	2.00	5.00
TN		WASHINGTON		25.00	25.00	25.00	12.50	12.50	1.00	1.00	10.00	10.00
VA		ALLEGHANY		1.00	7.00	5.00	12.50	12.50	1.00	5.00	5.00	10.00
VA		AUGUSTA		1.00	7.00	5.00	12.50	12.50	1.00	5.00	5.00	10.00
VA		BATH		1.00	7.00	5.00	12.50	12.50	1.00	5.00	5.00	10.00
VA		BOTETOURT		1.00	7.00	5.00	12.50	12.50	1.00	5.00	5.00	10.00
VA		BUCHANAN		1.00	20.00	7.00	12.50	12.50	3.00	5.00	3.00	10.00
VA		CHESTERFIELD		1.00	7.00	1.00	12.50	12.50	1.00	5.00	10.00	10.00
VA		FREDERICK		1.00	7.00	5.00	12.50	12.50	1.00	5.00	5.00	10.00
VA		HIGHLAND		1.00	7.00	5.00	12.50	12.50	1.00	5.00	5.00	10.00
VA		POWHATAN		1.00	5.00	1.00	12.50	12.50	1.00	3.00	5.00	10.00
VA		ROCKBRIDGE		1.00	7.00	5.00	12.50	12.50	1.00	5.00	5.00	10.00
VA		ROCKINGHAM		1.00	7.00	5.00	12.50	12.50	1.00	5.00	5.00	10.00
VA		SCOTT		25.00	25.00	25.00	12.50	12.50	1.00	[illegible]	10.00	10.00
VA		SHENANDOAH		1.00	7.00	5.00	12.50	12.50	1.00	5.00	5.00	10.00
VA		TAZEWELL		1.00	15.00	7.00	12.50	12.50	1.00	5.00	5.00	10.00

**** REGION #2 NORTHEAST ****

State	Sub.	County	Act	* Bonus in $$ per Acre * Low	High	Most Common *	Royalty Range Low%	High%	Rental Range $/Acre/Yr Low	High	Lease Term Years Low	High
IA		FREMONT		2.00	10.00	4.00	12.50	12.50	1.00	1.00	10.00	10.00
IA		PAGE		2.00	10.00	4.00	12.50	12.50	1.00	1.00	10.00	10.00
IL		ADAMS		3.00	35.00	10.00	12.50	12.50	1.00	10.00	1.00	5.00
IL		BOND		1.00	15.00	5.00	12.50	12.50	1.00	1.00	2.00	5.00
IL		BROWN	+x	15.00	150.00	50.00	12.50	50.00	1.00	1.00	0.50	3.00
IL		CHRISTIAN		5.00	20.00	10.00	12.50	12.50	1.00	5.00	1.00	3.00
IL		CLARK		5.00	15.00	5.00	12.50	12.50	1.00	1.00	1.00	3.00
IL		CLAY		10.00	50.00	20.00	12.50	18.75	1.00	25.00	0.50	2.00
IL		CLINTON		3.00	25.00	10.00	12.50	15.27	1.00	1.00	1.00	5.00
IL		COLES		3.00	15.00	5.00	12.50	12.50	1.00	5.00	1.00	3.00
IL		CRAWFORD		5.00	25.00	10.00	12.50	18.75	1.00	15.00	1.00	3.00
IL		CUMBERLAND		5.00	25.00	10.00	12.50	18.75	1.00	5.00	1.00	3.00
IL		DEWITT		1.00	15.00	5.00	12.50	12.50	1.00	1.00	1.00	5.00
IL		DOUGLAS		5.00	10.00	5.00	12.50	12.50	1.00	5.00	1.00	3.00
IL		EDGAR		5.00	15.00	10.00	12.50	12.50	1.00	5.00	1.00	3.00
IL		EDWARDS		10.00	30.00	25.00	12.50	18.75	5.00	25.00	0.50	2.00
IL		EFFINGHAM		5.00	25.00	10.00	12.50	18.75	1.00	10.00	1.00	3.00
IL		FAYETTE		10.00	30.00	15.00	12.50	18.75	5.00	15.00	0.50	3.00
IL		FRANKLIN		5.00	25.00	10.00	12.50	15.67	1.00	10.00	1.00	5.00
IL		FULTON	-0	1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
IL		GALLATIN		10.00	35.00	20.00	12.50	25.00	1.00	15.00	1.00	2.00
IL		GREENE		1.00	10.00	5.00	12.50	12.50	1.00	5.00	2.00	15.00
IL		HAMILTON		10.00	30.00	15.00	12.50	18.75	5.00	15.00	1.00	2.00
IL		HANCOCK		1.00	5.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
IL		HARDIN		5.00	15.00	10.00	12.50	12.50	1.00	5.00	1.00	3.00
IL		JACKSON		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	12.00
IL		JASPER		5.00	30.00	15.00	12.50	18.75	5.00	15.00	0.50	2.00
IL		JEFFERSON		5.00	50.00	20.00	12.50	18.75	5.00	15.00	0.50	2.00
IL		JERSEY		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
IL		JOHNSON		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	10.00
IL		LAWRENCE		5.00	25.00	10.00	12.50	15.67	1.00	10.00	1.00	2.00
IL		MACON		5.00	25.00	10.00	12.50	15.27	1.00	10.00	1.00	3.00
IL		MACOUPIN		1.00	10.00	5.00	12.50	12.50	1.00	1.00	1.00	5.00
IL		MADISON		3.00	10.00	5.00	12.50	12.50	1.00	1.00	2.00	5.00
IL		MARION		10.00	30.00	15.00	12.50	13.75	5.00	15.00	0.50	2.00
IL		MASON		1.00	3.00	2.00	12.50	12.50	1.00	1.00	3.00	12.00
IL		McDONOUGH		1.00	10.00	5.00	12.50	12.50	1.00	5.00	1.00	5.00
IL		MONROE		3.00	15.00	5.00	12.50	12.50	1.00	1.00	2.00	5.00
IL		MONTGOMERY		5.00	20.00	10.00	12.50	12.50	1.00	1.00	2.00	5.00
IL		MORGAN		5.00	10.00	5.00	12.50	12.50	1.00	1.00	1.00	3.00
IL		MOULTRIE		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
IL		PEORIA		5.00	15.00	10.00	12.50	12.50	1.00	1.00	3.00	5.00
IL		PERRY		5.00	15.00	5.00	12.50	18.75	1.00	1.00	2.00	5.00
IL		PIATT		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	10.00
IL		PIKE		5.00	15.00	10.00	12.50	12.50	1.00	1.00	1.00	5.00
IL		POPE		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	10.00
IL		RANDOLPH		1.00	10.00	5.00	12.50	12.50	1.00	1.00	2.00	5.00
IL		RICHLAND		5.00	25.00	15.00	12.50	15.67	5.00	10.00	0.50	2.00
IL		SALINE		10.00	30.00	15.00	12.50	18.75	10.00	15.00	0.50	2.00
IL		SANGAMON		5.00	25.00	15.00	12.50	16.67	1.00	10.00	1.00	3.00
IL		SCHUYLER		15.00	100.00	25.00	12.50	25.00	5.00	25.00	0.50	2.00
IL		SCOTT		5.00	15.00	10.00	12.50	12.50	1.00	1.00	1.00	5.00
IL		SHELBY		5.00	15.00	10.00	12.50	12.50	1.00	1.00	1.00	3.00
IL		ST. CLAIR		3.00	10.00	5.00	12.50	12.50	1.00	1.00	2.00	10.00
IL		UNION		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	10.00
IL		VERMILION		1.00	10.00	5.00	12.50	12.50	1.00	5.00	1.00	5.00
IL		WABASH		10.00	50.00	20.00	12.50	18.75	5.00	20.00	0.50	2.00
IL		WASHINGTON		5.00	30.00	10.00	12.50	15.67	1.00	1.00	2.00	2.00
IL		WAYNE		10.00	50.00	25.00	12.50	18.75	10.00	25.00	0.50	2.00
IL		WHITE		10.00	50.00	25.00	12.50	18.75	10.00	25.00	0.50	2.00
IL		WILLIAMSON		5.00	10.00	5.00	12.50	12.50	1.00	10.00	1.00	5.00
IN		ADAMS		1.00	10.00	3.00	12.50	12.50	1.00	1.00	2.00	10.00
IN		ALLEN		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		BENTON		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		BLACKFORD		1.00	10.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		CLAY		3.00	15.00	10.00	12.50	12.50	1.00	10.00	1.00	3.00
IN		DAVIESS		5.00	15.00	10.00	12.50	12.50	1.00	10.00	1.00	5.00
IN		DeKALB		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		DELAWARE		3.00	10.00	5.00	12.50	12.50	1.00	3.00	2.00	10.00
IN		DUBOIS		3.00	10.00	5.00	12.50	12.50	1.00	3.00	2.00	5.00
IN		ELKHART		1.00	5.00	2.00	12.50	12.50	1.00	1.00	2.00	5.00
IN		FAYETTE		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
IN		FOUNTAIN		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
IN		FRANKLIN		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
IN		GIBSON		5.00	50.00	15.00	12.50	18.75	5.00	20.00	0.50	2.00

**** REGION #2 NORTHEAST cont'd ****

State	Sub.	County	Act	* Bonus in $$ per Acre * Low	High	Most Common*	Royalty Range Low%	High%	Rental $/Acre/Yr Low	Range High	Lease Term Years Low	High
IN		GRANT		3.00	10.00	5.00	12.50	12.50	1.00	3.00	2.00	7.00
IN		GREENE		3.00	10.00	5.00	12.50	12.50	1.00	1.00	2.00	5.00
IN		HENRY		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
IN		HOWARD		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
IN		HUNTINGTON		1.00	3.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		JASPER		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	10.00
IN		JAY		3.00	5.00	3.00	12.50	12.50	1.00	3.00	2.00	10.00
IN		KNOX		5.00	15.00	10.00	12.50	12.50	1.00	5.00	1.00	3.00
IN		LAGRANGE		1.00	3.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
IN		LA PORTE		1.00	3.00	2.00	12.50	12.50	1.00	1.00	2.00	10.00
IN		LAWRENCE		3.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		MADISON		2.00	7.00	5.00	12.50	12.50	1.00	2.00	2.00	7.00
IN		MARION		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		MARTIN		3.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	7.00
IN		MIAMI		3.00	10.00	5.00	12.50	12.50	1.00	5.00	1.00	5.00
IN		MONROE		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		MONTGOMERY		1.00	5.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		NOBLE		1.00	3.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
IN		ORANGE		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	10.00
IN		OWEN		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	5.00
IN		PARKE		1.00	5.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		PERRY		3.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	5.00
IN		PIKE		5.00	15.00	5.00	12.50	15.25	1.00	5.00	1.00	5.00
IN		POSEY		5.00	50.00	15.00	12.50	18.75	5.00	15.00	0.50	2.00
IN		PULASKI		1.00	5.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		PUTNAM		1.00	3.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		RANDOLPH		3.00	7.00	5.00	12.50	12.50	1.00	1.00	3.00	7.00
IN		RUSH		2.00	7.00	3.00	12.50	12.50	1.00	3.00	3.00	10.00
IN		SHELBY		1.00	3.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		SPENCER		3.00	15.00	10.00	12.50	12.50	1.00	5.00	1.00	5.00
IN		ST. JOSEPH		1.00	5.00	2.00	12.50	12.50	1.00	1.00	2.00	5.00
IN		STEUBEN		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
IN		SULLIVAN		3.00	10.00	5.00	12.50	12.50	1.00	5.00	1.00	5.00
IN		TIPPECANOE		1.00	5.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		TIPTON		1.00	10.00	5.00	12.50	12.50	1.00	3.00	3.00	7.00
IN		UNION		1.00	3.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		VANDERBURGH		5.00	25.00	10.00	12.50	15.57	1.00	10.00	0.50	2.00
IN		VIGO		1.00	5.00	3.00	12.50	12.50	1.00	1.00	1.00	5.00
IN		WABASH		1.00	7.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		WARRICK		5.00	30.00	10.00	12.50	15.67	5.00	20.00	0.50	3.00
IN		WAYNE		1.00	3.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
IN		WELLS		1.00	3.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
IN		WHITLEY		1.00	3.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
KY		ADAIR		3.00	10.00	5.00	12.50	12.50	1.00	5.00	2.00	5.00
KY		ALLEN		3.00	10.00	5.00	12.50	16.67	1.00	5.00	2.00	7.00
KY		ANDERSON		10.00	25.00	15.00	12.50	12.50	1.00	1.00	1.00	2.00
KY		BARREN		1.00	10.00	3.00	12.50	12.50	1.00	3.00	2.00	7.00
KY		BOYD		3.00	6.00	5.00	12.50	12.50	1.00	2.00	1.00	3.00
KY		BREATHITT		5.00	15.00	10.00	12.50	12.50	1.00	1.00	1.00	5.00
KY		BRECKENRIDGE		2.00	5.00	3.00	12.50	12.50	1.00	3.00	2.00	5.00
KY		BUTLER		1.00	10.00	5.00	12.50	12.50	1.00	5.00	2.00	7.00
KY		CALDWELL		1.00	10.00	5.00	12.50	12.50	1.00	5.00	1.00	5.00
KY		CARTER		4.00	6.00	5.00	12.50	12.50	1.00	2.00	1.00	10.00
KY		CHRISTIAN		3.00	10.00	5.00	12.50	15.67	1.00	5.00	1.00	5.00
KY		CLAY		1.00	25.00	10.00	12.50	18.75	1.00	10.00	1.00	5.00
KY		CLINTON		1.00	5.00	3.00	12.50	12.50	1.00	3.00	2.00	7.00
KY		CRITTENDEN		1.00	10.00	5.00	12.50	12.50	1.00	5.00	1.00	5.00
KY		CUMBERLAND		1.00	10.00	3.00	12.50	12.50	1.00	3.00	2.00	7.00
KY		DAVIESS		5.00	15.00	10.00	12.50	15.67	3.00	10.00	1.00	3.00
KY		EDMONSON		3.00	10.00	5.00	12.50	12.50	3.00	5.00	2.00	5.00
KY		ELLIOT		5.00	15.00	7.50	12.50	12.50	1.00	1.00	3.00	5.00
KY		ESTILL		1.00	10.00	3.00	12.50	12.50	1.00	3.00	1.00	5.00
KY		GRAYSON		1.00	5.00	3.00	12.50	12.50	1.00	3.00	2.00	3.00
KY		GREEN		1.00	5.00	3.00	12.50	12.50	1.00	3.00	3.00	10.00
KY		GREENUP		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	7.00
KY		HANCOCK		5.00	10.00	5.00	12.50	12.50	1.00	10.00	1.00	3.00
KY		HARDIN		1.00	5.00	3.00	12.50	12.50	1.00	2.00	3.00	10.00
KY		HART		1.00	5.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
KY		HENDERSON		5.00	25.00	10.00	12.50	18.75	5.00	15.00	0.50	2.00
KY		HOPKINS		5.00	25.00	10.00	12.50	18.75	1.00	15.00	0.50	3.00
KY		JACKSON		1.00	5.00	2.00	12.50	12.50	1.00	2.00	2.00	5.00
KY		JOHNSON		5.00	25.00	10.00	12.50	12.50	1.00	1.00	1.00	3.00
KY		LARUE		1.00	3.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
KY		LAUREL		1.00	5.00	2.00	12.50	12.50	1.00	1.00	2.00	5.00
KY		LAWRENCE		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	7.00

**** REGION #2 NORTHEAST cont'd ****

State	Sub.	County	Act	Bonus in $$ per Acre Low	High	Most Common	Royalty Range Low%	High%	Rental $/Acre/Yr Low	Range High	Lease Term Years Low	High
KY		LEE		1.00	25.00	5.00	12.50	16.67	1.00	5.00	1.00	5.00
KY		LESLIE		1.00	10.00	3.00	12.50	12.50	1.00	5.00	1.00	5.00
KY		LOGAN		1.00	5.00	3.00	12.50	12.50	1.00	5.00	1.00	5.00
KY		MAGOFFIN		1.00	10.00	3.00	12.50	12.50	1.00	3.00	1.00	5.00
KY		MEADE		1.00	5.00	3.00	12.50	12.50	1.00	3.00	3.00	7.00
KY		MENIFEE		1.00	5.00	2.00	12.50	12.50	1.00	1.00	3.00	7.00
KY		METCALFE		3.00	10.00	5.00	12.50	12.50	3.00	5.00	2.00	5.00
KY		MCLEAN		5.00	20.00	10.00	12.50	18.75	5.00	15.00	1.00	3.00
KY		MONROE		1.00	10.00	5.00	12.50	12.50	1.00	3.00	2.00	3.00
KY		MUHLENBERG		3.00	25.00	10.00	12.50	25.00	1.00	10.00	1.00	3.00
KY		OHIO		3.00	15.00	10.00	12.50	18.75	1.00	10.00	1.00	3.00
KY		RUSSELL		1.00	10.00	5.00	12.50	12.50	1.00	1.00	1.00	5.00
KY		OWSLEY		1.00	10.00	3.00	12.50	12.50	1.00	3.00	2.00	5.00
KY		SIMPSON		1.00	5.00	3.00	12.50	12.50	1.00	3.00	2.00	7.00
KY		TODD		3.00	10.00	5.00	12.50	12.50	1.00	5.00	2.00	5.00
KY		TRIGG		1.00	3.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
KY		UNION		5.00	15.00	10.00	12.50	16.67	3.00	10.00	0.50	3.00
KY		WARREN		5.00	50.00	15.00	12.50	18.75	1.00	15.00	0.50	3.00
KY		WAYNE		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	5.00
KY		WEBSTER		5.00	25.00	10.00	12.50	18.75	5.00	15.00	0.50	2.00
KY		WOLFE		1.00	15.00	3.00	12.50	12.50	1.00	5.00	1.00	3.00
MD		ALLEGHENY		1.00	10.00	5.00	12.50	12.50	1.00	2.00	5.00	10.00
MD		GARRETT		1.00	15.00	5.00	12.50	12.50	1.00	7.00	5.00	5.00
MI		ALCONA		5.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI		ALLEGAN		5.00	25.00	10.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		ALPENA		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	S/2	ANTRIM		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	N/2	ANTRIM		5.00	10.00	5.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		ARENAC	x	5.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	N/2	BARRY		10.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	S/2	BARRY		10.00	35.00	25.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		BAY		5.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	SE/4	BENZIE		50.00	150.00	100.00	12.50	18.75	PD-UP	1.00	5.00	5.00
MI	SW/4	BENZIE		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	N/2	BENZIE		5.00	10.00	5.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		BERRIEN		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		BRANCH		5.00	25.00	10.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	NE/4	CALHOUN	x	15.00	100.00	50.00	12.50	16.67	PD-UP	1.00	3.00	7.00
MI	NW/4	CALHOUN		15.00	100.00	50.00	12.50	16.67	PD-UP	1.00	3.00	7.00
MI	SE/4	CALHOUN	x	15.00	100.00	50.00	12.50	16.67	PD-UP	1.00	3.00	7.00
MI	SW/4	CALHOUN		5.00	25.00	10.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI		CASS		5.00	25.00	10.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	S/2	CHARLEVOIX		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	N/2	CHARLEVOIX		5.00	5.00	5.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	SE/4	CHEBOYGEN		10.00	75.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	SW/4	CHEBOYGEN		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	N/2	CHEBOYGEN		5.00	10.00	5.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		CLARE		25.00	100.00	50.00	12.50	18.75	PD-UP	1.00	5.00	7.00
MI		CLINTON		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	NW/4	CRAWFORD		25.00	100.00	50.00	12.50	18.75	PD-UP	1.00	3.00	7.00
MI	NE/4	CRAWFORD		10.00	75.00	35.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	S/2	CRAWFORD		10.00	75.00	35.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	SW/4	EATON		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	SE/4	EATON		25.00	75.00	50.00	12.50	16.67	PD-UP	1.00	3.00	7.00
MI	N/2	EATON		5.00	15.00	10.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI		EMMETT	x	5.00	5.00	5.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		GENESEE		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	NE/4	GLADWIN		5.00	75.00	25.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	SW/4	GRAND TRAVERSE		50.00	150.00	100.00	12.50	18.75	PD-UP	1.00	1.00	5.00
MI	SE/4	GRAND TRAVERSE		25.00	150.00	75.00	12.50	18.75	PD-UP	1.00	1.00	5.00
MI	NW/4	GRAND TRAVERSE		5.00	75.00	50.00	12.50	16.67	PD-UP	1.00	1.00	5.00
MI	NE/4	GRAND TRAVERSE		5.00	150.00	75.00	12.50	18.75	PD-UP	1.00	1.00	5.00
MI		GRATIOT		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	N/2	HILLSDALE		25.00	125.00	50.00	12.50	16.67	PD-UP	1.00	3.00	7.00
MI	S/2	HILLSDALE		5.00	50.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		HURON		5.00	20.00	10.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	N/2	INGHAM		5.00	15.00	10.00	12.50	12.50	PD-UP	1.00	3.00	10.00
MI	S/2	INGHAM		20.00	100.00	50.00	12.50	16.67	PD-UP	1.00	3.00	7.00
MI		IONIA		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	E/2	IOSCO		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	W/2	IOSCO		15.00	50.00	35.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		ISABELLA		5.00	150.00	50.00	12.50	16.67	PD-UP	1.00	3.00	7.00
MI	SW/4	JACKSON	x	25.00	150.00	50.00	12.50	12.50	PD-UP	1.00	3.00	7.00
MI	REST	JACKSON		10.00	75.00	25.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	N/2	KALAMAZOO	x	5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00

**** REGION #2 NORTHEAST cont'd ****

State	Sub.	County	Act	* Bonus in $$ per Acre * Low	High	Most Common*	Royalty Range Low%	High%	Rental $/Acre/Yr Low	Range High	Lease Term Years Low	High
MI	S/2	KALAMAZOO		5.00	10.00	5.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	N/2	KALKASKA		25.00	150.00	75.00	12.50	18.75	PD-UP	1.00	3.00	7.00
MI	S/2	KALKASKA		25.00	75.00	50.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI		KENT		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	E/2	LAKE		10.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	W/2	LAKE		10.00	35.00	20.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI		LAPEER		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		LEELANAU		5.00	5.00	5.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	N/2	LENAWEE		5.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	S/2	LENAWEE		5.00	15.00	10.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	SE/4	LIVINGSTON		25.00	100.00	50.00	12.50	16.67	PD-UP	1.00	3.00	7.00
MI	REST	LIVINGSTON		5.00	50.00	15.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	N/2	MACOMB		15.00	50.00	25.00	12.50	12.50	PD-UP	1.00	3.00	7.00
MI	S/2	MACOMB		5.00	25.00	10.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	SW/4	MANISTEE		25.00	150.00	100.00	12.50	18.75	PD-UP	1.00	1.00	5.00
MI	NE/4	MANISTEE		25.00	150.00	100.00	12.50	18.75	PD-UP	1.00	1.00	5.00
MI	NW/4	MANISTEE		25.00	150.00	100.00	12.50	18.75	PD-UP	1.00	1.00	5.00
MI	SE/4	MANISTEE		5.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	E/2	MASON		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	W/2	MASON		25.00	100.00	50.00	12.50	16.67	PD-UP	1.00	3.00	7.00
MI		MECOSTA		15.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI		MIDLAND	x	10.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI		MISSAUKEE		25.00	75.00	50.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	W/2	MONROE		5.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	E/2	MONROE		5.00	10.00	5.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		MONTCALM		15.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	NW/4	MONTMORENCY		20.00	75.00	50.00	12.50	16.67	PD-UP	1.00	3.00	7.00
MI	NE/4	MONTMORENCY		5.00	50.00	20.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	S/2	MONTMORENCY		5.00	50.00	20.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI		MUSKEGON		5.00	25.00	10.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	E/2	NEWAYGO		5.00	75.00	35.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	W/2	NEWAYGO		5.00	30.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	SW/4	OAKLAND		25.00	75.00	50.00	12.50	16.67	PD-UP	1.00	3.00	5.00
MI	SE/4	OAKLAND		5.00	15.00	10.00	12.50	16.67	PD-UP	1.00	5.00	7.00
MI	N/2	OAKLAND		5.00	15.00	20.00	12.50	16.67	PD-UP	1.00	5.00	7.00
MI	W/2	OCEANA		25.00	100.00	50.00	12.50	18.75	PD-UP	1.00	3.00	7.00
MI	E/2	OCEANA		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI		OGEMAW		25.00	100.00	50.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI		OSCEOLA		15.00	100.00	50.00	12.50	16.67	PD-UP	1.00	5.00	7.00
MI	E/2	OSCODA		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	W/2	OSCODA		5.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	NW/4	OTSEGO		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	NE/4	OTSEGO		25.00	150.00	100.00	12.50	18.75	PD-UP	1.00	3.00	7.00
MI	SW/4	OTSEGO		25.00	150.00	100.00	12.50	18.75	PD-UP	1.00	3.00	7.00
MI	SE/4	OTSEGO		25.00	150.00	100.00	12.50	18.75	PD-UP	1.00	3.00	7.00
MI		OTTAWA		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	N/2	PRESQUE ISLE		5.00	50.00	20.00	12.50	16.67	PD-UP	1.00	5.00	7.00
MI	S/2	PRESQUE ISLE		25.00	75.00	50.00	12.50	18.75	PD-UP	1.00	3.00	5.00
MI		ROSCOMMON		15.00	75.00	25.00	12.50	16.67	PD-UP	1.00	5.00	7.00
MI		SAGINAW		5.00	25.00	20.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	N/2	ST. CLAIR		5.00	25.00	10.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	S/2	ST. CLAIR		5.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI		ST. JOSEPH		2.00	10.00	5.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		SANILAC		5.00	25.00	10.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		SHIAWASSEE		5.00	25.00	10.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI		TUSCOLA		5.00	25.00	10.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	N/2	VAN BUREN		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	S/2	VAN BUREN		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	E/2	WASHTENAW		5.00	25.00	15.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	W/2	WASHTENAW		15.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI		WAYNE		5.00	5.00	5.00	12.50	12.50	PD-UP	1.00	5.00	10.00
MI	NW/4	WEXFORD		25.00	100.00	50.00	12.50	18.75	PD-UP	1.00	3.00	7.00
MI	NE/4	WEXFORD		5.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MI	S/2	WEXFORD		5.00	50.00	25.00	12.50	12.50	PD-UP	1.00	5.00	7.00
MO		ATCHISON		3.00	5.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
MO		BATES		5.00	10.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
MO		CALDWELL		3.00	5.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
MO		CASS		5.00	10.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
MO		HOLT		3.00	5.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
MO		PLATTE		3.00	5.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
MO		RAY		3.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	5.00
MO		VERNON		3.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	5.00
NJ		SUSSEX		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	5.00
NY		ALBANY		1.00	1.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
NY		ALLEGANY		3.00	15.00	10.00	12.50	12.50	1.00	5.00	1.00	5.00

**** REGION #2 NORTHEAST cont'd ****

State	Sub.	County	Act	* Bonus in $$ per Acre * Low	High	Most Common *	Royalty Range Low%	High%	Rental Range $/Acre/Yr Low	High	Lease Term Years Low	High
NY		BROOME	x	3.00	5.00	4.00	12.50	12.50	1.00	5.00	5.00	10.00
NY		CATTARAUGUS		5.00	25.00	10.00	12.50	12.50	1.00	5.00	3.00	5.00
NY		CAYUGA		2.00	5.00	3.00	12.50	12.50	2.00	3.00	3.00	10.00
NY		CHAUTAUQUA	x	10.00	100.00	25.00	12.50	12.50	5.00	20.00	1.00	5.00
NY		DUTCHESS		3.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
NY		LIVINGSTON		1.00	5.00	2.00	12.50	12.50	1.00	3.00	3.00	10.00
NY		MADISON		1.00	5.00	2.00	12.50	12.50	1.00	3.00	3.00	7.00
NY		ONEIDA		1.00	5.00	2.00	12.50	12.50	1.00	3.00	3.00	7.00
NY		ONTARIO		1.00	5.00	2.00	12.50	12.50	1.00	3.00	3.00	7.00
NY		ORANGE		3.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
NY		RENSSELAER		1.00	2.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
NY		SARATOGA		1.00	1.00	1.00	12.50	12.50	1.00	1.00	7.00	10.00
NY		SENECA		2.00	4.00	3.00	12.50	12.50	2.00	3.00	5.00	10.00
NY		STEUBEN		2.00	7.00	5.00	12.50	12.50	2.00	10.00	5.00	10.00
NY		SULLIVAN		5.00	5.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
NY		TOMPKINS		2.00	5.00	3.00	12.50	12.50	1.00	2.00	5.00	10.00
NY		WARREN		1.00	1.00	1.00	12.50	12.50	1.00	1.00	7.00	10.00
NY		WASHINGTON		1.00	2.00	1.00	12.50	12.50	1.00	2.00	5.00	10.00
NY		WAYNE		2.00	2.50	2.00	12.50	12.50	2.00	2.00	5.00	10.00
NY		WYOMING		1.00	7.00	2.00	12.50	12.50	1.00	3.00	3.00	7.00
NY		YATES		2.00	4.00	3.00	12.50	12.50	3.00	5.00	3.00	7.00
OH		ADAMS		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		ALLEN		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		ASHTABULA		3.00	20.00	10.00	12.50	12.50	1.00	10.00	1.00	5.00
OH		ATHENS		1.00	10.00	3.00	12.50	12.50	1.00	10.00	1.00	3.00
OH		AUGLAIZE		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		BELMONT		1.00	5.00	3.00	12.50	12.50	1.00	3.00	5.00	10.00
OH		CLINTON		1.00	5.00	3.00	12.50	12.50	1.00	2.00	3.00	10.00
OH		COLUMBIANA		5.00	15.00	10.00	12.50	12.50	1.00	3.00	1.00	5.00
OH		CUYAHOGA		3.00	20.00	10.00	12.50	12.50	1.00	15.00	1.00	5.00
OH		DELAWARE		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		ERIE		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		FAYETTE		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		FULTON		1.00	3.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		GALLIA		1.00	5.00	3.00	12.50	12.50	1.00	3.00	5.00	10.00
OH		GEAUGA		5.00	20.00	15.00	12.50	12.50	1.00	15.00	1.00	5.00
OH		GREENE		1.00	20.00	2.00	12.50	12.50	1.00	3.00	3.00	5.00
OH		HARDIN		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		HARRISON		2.00	15.00	5.00	12.50	12.50	1.00	3.00	3.00	5.00
OH		HIGHLAND		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		HOCKING		1.00	10.00	3.00	12.50	12.50	1.00	5.00	3.00	10.00
OH		HURON		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		JACKSON		1.00	10.00	3.00	12.50	12.50	1.00	5.00	1.00	5.00
OH		LAKE		3.00	20.00	10.00	12.50	12.50	1.00	15.00	2.00	5.00
OH		LAWRENCE		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		LOGAN		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		MADISON		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		MAHONING		5.00	15.00	10.00	12.50	12.50	1.00	3.00	1.00	5.00
OH		MARION		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		MEDINA		5.00	20.00	10.00	12.50	12.50	5.00	10.00	1.00	3.00
OH		MEIGS		1.00	7.00	3.00	12.50	12.50	1.00	3.00	3.00	5.00
OH		MERCER		1.00	3.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		MONROE		1.00	5.00	3.00	12.50	12.50	1.00	3.00	5.00	15.00
OH		MORGAN		1.00	5.00	3.00	12.50	12.50	1.00	3.00	3.00	5.00
OH		MUSKINGUM		5.00	20.00	10.00	12.50	12.50	1.00	3.00	1.00	5.00
OH		NOBLE		1.00	5.00	3.00	12.50	12.50	1.00	3.00	5.00	10.00
OH		OTTAWA		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		PERRY		3.00	10.00	5.00	12.50	12.50	1.00	5.00	2.00	5.00
OH		PICKAWAY		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		PIKE		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		PORTAGE		5.00	20.00	10.00	12.50	12.50	1.00	10.00	1.00	5.00
OH		PUTNAM		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		RICHLAND		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		ROSS		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	7.00
OH		SANDUSKY		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		SENECA		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		SCIOTO		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		SUMMIT		5.00	15.00	10.00	12.50	12.50	1.00	10.00	2.00	5.00
OH		TRUMBULL		5.00	20.00	15.00	12.50	12.50	1.00	15.00	1.00	5.00
OH		UNION		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		VAN WERT		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		WASHINGTON		1.00	5.00	3.00	12.50	12.50	1.00	3.00	5.00	10.00
OH		WAYNE		5.00	20.00	10.00	12.50	12.50	5.00	10.00	1.00	3.00
OH		WILLIAMS		1.00	3.00	2.00	12.50	12.50	1.00	1.00	3.00	10.00
OH		WOOD		1.00	5.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00

**** REGION #2 NORTHEAST cont'd ****

State	Sub.	County	Act	Bonus in $$ per Acre Low	High	Most Common	Royalty Range Low%	High%	Rental Range $/Acre/Yr Low	High	Lease Term Years Low	High
OH		WYANDOT		1.00	3.00	1.00	12.50	12.50	1.00	1.00	3.00	10.00
PA		ALLEGHENY		1.00	50.00	5.00	12.50	12.50	1.00	7.00	1.00	10.00
PA		ARMSTRONG		3.00	20.00	10.00	12.50	12.50	1.00	10.00	3.00	10.00
PA		BEAVER		5.00	20.00	15.00	12.50	12.50	5.00	25.00	0.50	3.00
PA		BEDFORD		2.00	5.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
PA		BLAIR		1.00	5.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
PA		BRADFORD		1.00	3.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
PA		BUTLER		1.00	15.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
PA		CAMBRIA		3.00	10.00	5.00	12.50	12.50	1.00	5.00	3.00	10.00
PA		CAMERON		1.00	10.00	3.00	12.50	12.50	1.00	3.00	3.00	10.00
PA		CENTRE		2.00	25.00	10.00	12.50	12.50	1.00	3.00	3.00	10.00
PA		CLARION		1.00	10.00	5.00	12.50	12.50	1.00	3.00	3.00	10.00
PA		CLEARFIELD		3.00	25.00	10.00	12.50	12.50	1.00	5.00	1.00	10.00
PA		CLINTON		2.00	25.00	15.00	12.50	12.50	1.00	5.00	1.00	10.00
PA		CRAWFORD		1.00	40.00	15.00	12.50	12.50	1.00	5.00	1.00	10.00
PA		CUMBERLAND		3.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
PA		DAUPHIN		3.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
PA		ELK		3.00	15.00	5.00	12.50	12.50	1.00	1.00	3.00	10.00
PA		ERIE		5.00	40.00	15.00	12.50	12.50	1.00	5.00	1.00	10.00
PA		FAYETTE		1.00	25.00	10.00	12.50	12.50	1.00	5.00	1.00	10.00
PA		FOREST		1.00	25.00	10.00	12.50	12.50	1.00	5.00	1.00	10.00
PA		FRANKLIN		1.00	3.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
PA		FULTON		1.00	5.00	3.00	12.50	12.50	1.00	5.00	5.00	10.00
PA		GREENE		5.00	15.00	10.00	12.50	12.50	1.00	5.00	5.00	10.00
PA		HUNTINGTON		1.00	5.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
PA		INDIANA		3.00	25.00	15.00	12.50	12.50	1.00	5.00	0.50	3.00
PA		JEFFERSON		5.00	35.00	10.00	12.50	12.50	1.00	10.00	2.00	10.00
PA		LEBANON		3.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
PA		LYCOMING		2.00	15.00	5.00	12.50	12.50	1.00	5.00	3.00	5.00
PA		MCKEAN		1.00	15.00	5.00	12.50	12.50	1.00	5.00	1.00	10.00
PA		MERCER		1.00	40.00	15.00	12.50	12.50	1.00	5.00	1.00	10.00
PA		PIKE		3.00	3.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
PA		POTTER		1.00	10.00	5.00	12.50	12.50	1.00	5.00	3.00	10.00
PA		SOMERSET		3.00	25.00	15.00	12.50	12.50	1.00	5.00	3.00	10.00
PA		TIOGA		2.00	12.99	5.00	12.50	12.50	1.00	1.00	3.00	10.00
PA		VENANGO		1.00	40.00	15.00	12.50	12.50	1.00	5.00	0.50	3.00
PA		WARREN		1.00	35.00	15.00	12.50	18.75	1.00	10.00	1.00	10.00
PA		WASHINGTON		1.00	15.00	5.00	12.50	12.50	1.00	3.00	1.00	10.00
PA		WAYNE		5.00	5.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
PA		WESTMORELAND		5.00	15.00	10.00	12.50	12.50	1.00	3.00	1.00	10.00
VT		FRANKLIN		1.00	3.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
VT		GRAND ISLE		1.00	3.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
WV		BARBOUR		2.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
WV		BERKELEY		1.00	1.00	1.00	12.50	12.50	1.00	10.00	10.00	10.00
WV		BOONE		1.00	5.00	2.00	12.50	12.50	1.00	5.00	3.00	10.00
WV		BRAXTON		2.00	10.00	4.00	12.50	20.00	2.00	10.00	5.00	10.00
WV		BROOKE		1.00	5.00	2.00	12.50	12.50	1.00	5.00	1.00	10.00
WV		CABELL		1.00	5.00	3.00	12.50	12.50	3.00	7.00	2.00	5.00
WV		CALHOUN		2.00	10.00	5.00	12.50	12.50	1.00	1.00	1.00	20.00
WV		CLAY		4.00	7.00	5.00	12.50	12.50	2.00	11.00	1.00	10.00
WV		DODDRIDGE		3.00	20.00	5.00	12.50	12.50	1.00	15.00	6.00	10.00
WV		FAYETTE		1.00	12.00	5.00	12.50	12.50	1.00	5.00	1.00	10.00
WV		GILMER		2.00	25.00	5.00	12.50	12.50	1.00	5.00	1.00	10.00
WV		GRANT		1.00	1.00	1.00	12.50	12.50	1.00	3.00	3.00	10.00
WV		GREENBRIER		1.00	7.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
WV		HAMPSHIRE		1.00	1.00	1.00	12.50	12.50	1.00	1.00	5.00	10.00
WV		HANCOCK		1.00	2.00	2.00	12.50	12.50	1.00	2.00	5.00	10.00
WV		HARDY		1.00	2.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
WV		HARRISON		2.00	10.00	3.00	12.50	12.50	1.00	5.00	0.50	12.00
WV		JACKSON		5.00	10.00	10.00	12.50	12.50	2.00	5.00	1.00	10.00
WV		JEFFERSON		1.00	1.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
WV		KANAWHA		3.00	15.00	5.00	12.50	12.50	1.00	5.00	1.00	10.00
WV		LEWIS		2.00	10.00	5.00	12.50	12.50	1.00	5.00	1.00	10.00
WV		LINCOLN		1.00	10.00	5.00	12.50	12.50	1.00	5.00	1.00	5.00
WV		LOGAN		1.00	3.00	2.00	12.50	12.50	1.00	3.00	5.00	5.00
WV		MARION		2.00	10.00	3.00	12.50	12.50	1.00	10.00	1.00	10.00
WV		MARSHALL		2.00	3.00	3.00	12.50	12.50	1.00	3.00	5.00	10.00
WV		MCDOWELL		2.00	5.00	4.00	12.50	12.50	2.00	5.00	1.00	10.00
WV		MERCER		1.00	2.00	1.00	12.50	12.50	1.00	2.00	5.00	10.00
WV		MINERAL		1.00	5.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
WV		MINGO		1.00	5.00	1.00	12.50	12.50	2.00	5.00	0.50	5.00
WV		MONONGALIA		1.00	5.00	3.00	12.50	12.50	1.00	10.00	5.00	10.00
WV		MONROE		1.00	5.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
WV		NICHOLAS		1.00	10.00	5.00	12.50	12.50	2.00	10.00	1.00	5.00
WV		OHIO		1.00	5.00	5.00	12.50	12.50	1.00	5.00	2.00	5.00

**** REGION #2 NORTHEAST cont'd ****

State	Sub.	County	Act	Bonus in $$ per Acre Low	High	Most Common	Royalty Range Low%	High%	Rental $/Acre/Yr Low	High	Lease Term Years Low	High
WV		PENDLETON		2.00	7.00	3.00	12.50	12.50	1.00	5.00	1.00	10.00
WV		PLEASANTS		5.00	20.00	10.00	12.50	12.50	5.00	12.00	1.00	10.00
WV		POCAHONTAS		1.00	5.00	1.00	12.50	12.50	1.00	1.00	10.00	15.00
WV		PRESTON		1.00	3.00	2.00	12.50	12.50	1.00	1.00	1.00	10.00
WV		PUTNAM		2.00	5.00	3.00	12.50	12.50	3.00	7.50	2.00	5.00
WV		RALEIGH		1.00	10.00	3.00	12.50	12.50	1.00	5.00	3.00	10.00
WV		RANDOLPH		2.00	10.00	3.00	12.50	12.50	2.00	5.00	1.00	10.00
WV		RITCHIE		2.00	100.00	20.00	12.50	25.00	1.00	40.00	1.00	10.00
WV		ROANE		3.00	8.00	5.00	12.50	12.50	1.00	2.00	1.00	10.00
WV		SUMMERS		1.00	3.00	2.00	12.50	12.50	1.00	2.00	5.00	10.00
WV		TAYLOR		2.00	15.00	5.00	12.50	12.50	1.00	5.00	1.00	20.00
WV		TUCKER		2.00	10.00	5.00	12.50	12.50	1.00	5.00	1.00	10.00
WV		TYLER		1.00	20.00	3.00	12.50	12.50	1.00	5.00	1.00	10.00
WV		UPSHUR		2.00	25.00	3.00	12.50	12.50	1.00	15.00	1.00	10.00
WV		WAYNE		2.00	5.00	3.00	12.50	12.50	3.00	7.50	2.00	5.00
WV		WEBSTER		2.00	15.00	5.00	12.50	12.50	1.00	7.00	1.00	10.00
WV		WETZEL		2.00	10.00	3.00	12.50	12.50	2.00	5.00	1.00	10.00
WV		WIRT		2.00	15.00	7.00	12.50	12.50	1.00	30.00	1.00	10.00
WV		WOOD		2.00	7.00	2.00	12.50	12.50	1.00	5.00	1.00	10.00
WV		WYOMING		1.50	3.00	3.00	12.50	12.50	1.00	3.00	1.00	5.00

**** REGION #3 EAST TEXAS ****

State	Sub.	County	Act	Bonus in $$ per Acre Low	High	Most Common	Royalty Range Low%	High%	Rental $/Acre/Yr Low	High	Lease Term Years Low	High
TX		ANDERSON		50.00	100.00	75.00	12.50	16.67	1.00	3.00	3.00	5.00
TX		ANGELINA		35.00	75.00	50.00	12.50	16.67	1.00	5.00	3.00	5.00
TX	N/2	ARCHER		20.00	60.00	25.00	12.50	18.75	1.00	1.00	3.00	5.00
TX	S/2	ARCHER		20.00	60.00	35.00	12.50	18.75	1.00	1.00	3.00	5.00
TX		BAYLOR		15.00	50.00	27.50	12.50	18.75	1.00	1.00	3.00	5.00
TX		BOSQUE		10.00	35.00	25.00	12.50	16.67	1.00	3.00	5.00	10.00
TX		BOWIE		25.00	150.00	50.00	12.50	18.75	1.00	1.00	1.00	5.00
TX		CAMP		25.00	75.00	35.00	12.50	25.00	1.00	5.00	1.00	5.00
TX		CASS		50.00	250.00	100.00	12.50	25.00	1.00	10.00	2.00	5.00
TX		CHEROKEE		50.00	125.00	50.00	12.50	18.75	1.00	5.00	3.00	5.00
TX		CLAY		17.50	75.00	50.00	12.50	18.75	1.00	1.00	3.00	3.00
TX		COLLIN		35.00	75.00	50.00	12.50	16.67	1.00	3.00	3.00	5.00
TX		COOKE		25.00	75.00	50.00	16.67	18.75	1.00	1.00	3.00	3.00
TX		DELTA		15.00	40.00	25.00	12.50	16.67	1.00	1.00	3.00	5.00
TX		DENTON		17.50	50.00	30.00	12.50	12.50	1.00	1.00	3.00	3.00
TX		ELLIS		25.00	50.00	35.00	12.50	16.67	1.00	3.00	5.00	10.00
TX		FALLS		25.00	50.00	50.00	12.50	16.67	1.00	2.00	5.00	10.00
TX		FANNIN		15.00	35.00	25.00	12.50	12.50	1.00	1.00	5.00	5.00
TX		FOARD		10.00	30.00	25.00	12.50	12.50	1.00	1.00	3.00	5.00
TX		FRANKLIN		25.00	100.00	35.00	12.50	25.00	1.00	3.00	1.00	5.00
TX		FREESTONE		75.00	100.00	75.00	16.67	18.75	2.00	3.00	1.00	5.00
TX		GRAYSON		25.00	125.00	50.00	16.67	18.75	1.00	1.00	3.00	3.00
TX		GREGG		35.00	100.00	50.00	12.50	12.50	1.00	5.00	3.00	5.00
TX	E/2	HARDEMAN		25.00	325.00	80.00	18.75	18.75	1.00	1.00	2.00	3.00
TX	W/2	HARDEMAN		20.00	75.00	40.00	12.50	18.75	1.00	1.00	3.00	5.00
TX		HARRISON		75.00	150.00	125.00	12.50	16.67	2.00	3.00	3.00	5.00
TX		HENDERSON		50.00	100.00	50.00	12.50	18.75	2.50	3.00	3.00	5.00
TX		HILL		10.00	35.00	25.00	12.50	16.67	1.00	3.00	5.00	10.00
TX	N/2	HOPKINS		35.00	100.00	50.00	12.50	25.00	1.00	5.00	1.00	5.00
TX	S/2	HOPKINS		35.00	75.00	35.00	12.50	16.67	1.00	3.00	3.00	5.00
TX		HOUSTON		50.00	75.00	50.00	12.50	18.75	1.00	3.00	3.00	5.00
TX		HUNT		20.00	50.00	35.00	12.50	16.67	1.00	1.00	3.00	5.00
TX		JACK		17.50	55.00	37.50	16.67	18.75	1.00	1.00	3.00	3.00
TX		JOHNSON		10.00	35.00	25.00	12.50	16.67	1.00	3.00	5.00	10.00
TX		KAUFMAN		35.00	75.00	50.00	12.50	16.67	1.00	2.00	3.00	5.00
TX		KNOX		15.00	40.00	25.00	12.50	12.50	1.00	1.00	3.00	3.00
TX		LAMAR		15.00	40.00	25.00	12.50	16.67	1.00	1.00	3.00	5.00
TX		LEON		50.00	100.00	75.00	16.67	18.75	2.00	3.00	2.00	5.00
TX		LIMESTONE		75.00	200.00	100.00	12.50	25.00	1.00	5.00	3.00	5.00
TX		MARION		50.00	100.00	75.00	12.50	18.75	1.00	3.00	3.00	5.00
TX		MCLENNAN		10.00	35.00	25.00	12.50	16.67	1.00	3.00	5.00	10.00
TX		MONTAGUE		20.00	55.00	45.00	16.67	18.75	1.00	1.00	3.00	3.00
TX	N/2	MORRIS		25.00	75.00	35.00	12.50	25.00	1.00	5.00	3.00	5.00
TX	S/2	MORRIS		35.00	50.00	35.00	12.50	18.75	1.00	1.00	5.00	5.00
TX		NACOGDOCHES		100.00	200.00	150.00	12.50	25.00	2.50	5.00	3.00	5.00
TX		NAVARRO		75.00	200.00	100.00	12.50	25.00	2.50	3.00	3.00	5.00
TX		PANOLA		50.00	100.00	50.00	16.67	18.75	1.00	3.00	3.00	5.00
TX		RAINS		35.00	100.00	50.00	12.50	25.00	1.00	1.00	2.00	5.00
TX	N/2	RED RIVER		15.00	35.00	25.00	12.50	16.67	1.00	1.00	3.00	10.00
TX	S/2	RED RIVER		25.00	50.00	35.00	12.50	18.75	1.00	1.00	3.00	5.00
TX		ROBERTSON		75.00	125.00	100.00	12.50	25.00	2.00	5.00	3.00	5.00
TX	S/2	ROBERTSON		100.00	200.00	125.00	18.75	20.00	1.00	3.00	3.00	5.00
TX		RUSK		50.00	100.00	50.00	12.50	25.00	1.00	3.00	1.00	5.00

**** REGION #3 EAST TEXAS cont'd ****

State	Sub.	County	Act	Bonus in $$ per Acre Low	High	Most Common	Royalty Range Low%	High%	Rental Range $/Acre/Yr Low	High	Lease Term Years Low	High
TX		SABINE		50.00	100.00	75.00	12.50	25.00	1.00	5.00	1.00	5.00
TX		SAN AUGUSTINE		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		TARRANT		35.00	50.00	35.00	12.50	[illegible]	1.00	2.00	3.00	5.00
TX	N/2	[illegible]		[illegible]	75.00	50.00	12.50	25.00	1.00	5.00	1.00	5.00
TX	S/2	[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		WICHITA		10.00	40.00	25.00	12.50	18.75	1.00	1.00	3.00	3.00
TX		WILBARGER		15.00	50.00	25.00	12.50	[illegible]	1.00	1.00	3.00	3.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		YOUNG		[illegible]	50.00	40.00	18.75	18.75	1.00	1.00	3.00	3.00

**** REGION #4 TEXAS GULF COAST ****

State	Sub.	County	Act	Bonus in $$ per Acre Low	High	Most Common	Royalty Range Low%	High%	Rental Range $/Acre/Yr Low	High	Lease Term Years Low	High
TX		ARANSAS		50.00	100.00	75.00	16.67	25.00	5.00	10.00	1.00	3.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		10.00	25.00	15.00	12.50	[illegible]	1.00	1.00	5.00	5.00
TX		BASTROP		20.00	75.00	30.00	16.67	18.75	1.00	3.00	3.00	5.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		BLANCO		7.50	10.00	7.50	12.50	12.50	1.00	1.00	5.00	10.00
TX		[illegible]		125.00	150.00	120.00	16.67	25.00	5.00	25.00	3.00	5.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		BURNET		5.00	12.50	10.00	12.50	12.50	1.00	1.00	5.00	10.00
TX		CALDWELL		20.00	75.00	30.00	16.67	18.75	1.00	3.00	3.00	5.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		COLORADO		75.00	175.00	110.00	16.67	25.00	5.00	25.00	3.00	5.00
TX		[illegible]		10.00	15.00	12.50	12.50	16.67	1.00	2.00	5.00	10.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		EDWARDS		10.00	50.00	20.00	12.50	18.75	1.00	1.00	5.00	5.00
TX	N/2	FAYETTE		100.00	250.00	135.00	16.67	25.00	5.00	35.00	3.00	5.00
TX	S/2	[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		FORT BEND		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		GALVESTON		50.00	200.00	125.00	16.67	25.00	5.00	25.00	3.00	5.00
TX		GILLESPIE		5.00	12.50	10.00	12.50	16.67	1.00	1.00	5.00	10.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		GUADALUPE		100.00	300.00	150.00	[illegible]	25.00	1.00	5.00	3.00	5.00
TX		HARDIN		[illegible]	250.00	100.00	16.67	25.00	5.00	35.00	3.00	5.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		JACKSON	*x*	75.00	150.00	100.00	16.67	25.00	5.00	10.00	1.00	5.00
TX		JASPER		50.00	125.00	75.00	16.67	25.00	5.00	25.00	3.00	5.00
TX		JEFFERSON		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		JIM HOGG		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		JIM WELLS		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		KARNES		50.00	125.00	100.00	16.67	25.00	5.00	10.00	2.00	5.00
TX		KENDALL		5.00	15.00	7.50	12.50	16.67	1.00	1.00	5.00	10.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		KLEBERG		75.00	125.00	75.00	16.67	25.00	5.00	10.00	2.00	4.00
TX		LA SALLE		25.00	150.00	75.00	12.50	25.00	2.00	5.00	3.00	5.00
TX		LAVACA		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		LIBERTY		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		LIVE OAK		35.00	300.00	150.00	16.67	25.00	5.00	20.00	2.00	3.00
TX		LLANO		5.00	10.00	7.50	12.50	12.50	1.00	1.00	5.00	10.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		MATAGORDA		[illegible]	[illegible]	125.00	[illegible]	[illegible]	10.00	35.00	[illegible]	[illegible]
TX		MAVERICK		15.00	150.00	35.00	12.50	25.00	1.00	1.00	3.00	5.00

**** REGION #4 TEXAS GULF COAST cont'd **

State	Sub.	County	Act	Bonus in $$ per Acre Low	High	Most Common	Royalty Range Low%	High%	Rental $/Acre/Yr Low	Range High	Lease Term Years Low	High
TX		MCMULLEN		100.00	400.00	150.00	13.75	25.00	10.00	10.00	3.00	3.00
TX		MEDINA		10.00	25.00	15.00	12.50	16.67	1.00	2.00	5.00	10.00
TX		MILAM		10.00	25.00	15.00	12.50	16.67	1.00	1.00	5.00	5.00
TX		MONTGOMERY		75.00	150.00	125.00	16.67	25.00	5.00	30.00	3.00	5.00
TX		NEWTON		50.00	125.00	75.00	16.67	25.00	5.00	25.00	3.00	5.00
TX		NUECES		60.00	150.00	125.00	16.67	25.00	5.00	10.00	1.00	3.00
TX		ORANGE		25.00	225.00	100.00	16.67	25.00	5.00	50.00	3.00	5.00
TX		POLK		50.00	200.00	75.00	16.67	25.00	5.00	10.00	3.00	5.00
TX		REAL		10.00	25.00	15.00	12.50	16.67	1.00	1.00	5.00	5.00
TX		REFUGIO		75.00	125.00	100.00	15.67	25.00	5.00	20.00	1.00	3.00
TX		SAN JACINTO		50.00	125.00	80.00	16.67	20.00	5.00	10.00	3.00	5.00
TX		SAN PATRICIO		50.00	150.00	100.00	16.67	25.00	5.00	10.00	1.00	5.00
TX		STARR		50.00	150.00	75.00	16.67	25.00	5.00	10.00	2.00	5.00
TX		TRAVIS		10.00	50.00	20.00	12.50	16.67	1.00	1.00	5.00	5.00
TX		TRINITY		50.00	150.00	100.00	15.67	20.00	5.00	10.00	3.00	5.00
TX		TYLER		50.00	100.00	75.00	15.67	20.00	5.00	10.00	3.00	5.00
TX		UVALDE		5.00	25.00	15.00	12.50	16.67	1.00	1.00	5.00	10.00
TX	S/2	VAL VERDE		10.00	40.00	25.00	12.50	16.67	1.00	1.00	3.00	5.00
TX	N/2	VAL VERDE		25.00	75.00	45.00	16.67	18.75	1.00	1.00	3.00	5.00
TX		VICTORIA		75.00	150.00	100.00	15.67	25.00	5.00	10.00	1.00	3.00
TX		WALKER		65.00	125.00	100.00	15.67	20.00	5.00	10.00	3.00	5.00
TX		WALLER		75.00	200.00	125.00	16.67	25.00	5.00	30.00	3.00	5.00
TX		WASHINGTON		85.00	150.00	125.00	16.67	20.00	5.00	10.00	3.00	5.00
TX		WEBB		50.00	350.00	150.00	16.67	25.00	5.00	10.00	2.00	5.00
TX		WHARTON	x	75.00	175.00	100.00	16.67	25.00	5.00	25.00	3.00	5.00
TX		WILLACY		50.00	150.00	100.00	16.67	25.00	5.00	10.00	2.00	5.00
TX		WILLIAMSON		10.00	25.00	15.00	12.50	16.67	1.00	2.00	5.00	5.00
TX		WILSON		100.00	300.00	175.00	18.75	25.00	2.00	5.00	3.00	5.00
TX		ZAPATA		100.00	300.00	200.00	16.67	25.00	5.00	25.00	1.00	3.00
TX		ZAVALA		20.00	150.00	30.00	12.50	18.75	1.00	5.00	3.00	5.00

**** REGION #5 WEST TEXAS ****

State	Sub.	County	Act	Bonus in $$ per Acre Low	High	Most Common	Royalty Range Low%	High%	Rental $/Acre/Yr Low	Range High	Lease Term Years Low	High
NM	NE	CHAVES		50.00	150.00	75.00	13.75	18.75	1.00	1.00	3.00	5.00
NM	NW	CHAVES		50.00	150.00	75.00	13.75	18.75	1.00	1.00	3.00	5.00
NM	SE	CHAVES		50.00	150.00	75.00	13.75	18.75	1.00	1.00	5.00	10.00
NM	SW	CHAVES		5.00	25.00	10.00	12.50	12.50	1.00	1.00	10.00	10.00
NM		CURRY		10.00	50.00	25.00	12.50	18.75	1.00	1.00	5.00	10.00
NM	S/2	DE BACA		25.00	75.00	50.00	12.50	18.75	1.00	1.00	5.00	10.00
NM	N/2	DE BACA		10.00	50.00	25.00	12.50	18.75	1.00	1.00	5.00	10.00
NM	EAST	EDDY	+x	75.00	200.00	150.00	13.75	25.00	1.00	2.00	3.00	5.00
NM	WEST	EDDY	+x	75.00	175.00	150.00	12.50	18.75	1.00	1.00	5.00	10.00
NM		GUADALUPE	+x	5.00	25.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
NM	S/2	LEA	-x	15.00	300.00	100.00	18.75	25.00	1.00	2.00	3.00	5.00
NM	N/2	LEA	-x	50.00	250.00	100.00	18.75	18.75	1.00	1.00	3.00	5.00
NM		LINCOLN		5.00	15.00	10.00	12.50	12.50	1.00	1.00	10.00	10.00
NM		OTERO		5.00	15.00	10.00	12.50	12.50	1.00	1.00	10.00	10.00
NM	S/2	ROOSEVELT		50.00	100.00	75.00	18.75	25.00	1.00	1.00	3.00	5.00
NM	N/2	ROOSEVELT		25.00	75.00	50.00	12.50	18.75	1.00	1.00	5.00	10.00
NM		QUAY		10.00	35.00	25.00	12.50	15.67	1.00	1.00	5.00	10.00
TX		ANDREWS		100.00	175.00	125.00	18.75	25.00	1.00	1.00	1.00	3.00
TX		ARMSTRONG		1.00	3.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
TX		BAILEY		10.00	45.00	10.00	12.50	18.75	1.00	1.00	3.00	5.00
TX		BORDEN		35.00	95.00	45.00	13.75	25.00	1.00	1.00	3.00	5.00
TX		BREWSTER		10.00	35.00	20.00	12.50	18.75	1.00	1.00	5.00	5.00
TX		BRISCOE		2.00	40.00	25.00	12.50	15.67	1.00	1.00	5.00	10.00
TX		BROWN		7.50	25.00	12.50	12.50	18.75	1.00	1.00	1.00	3.00
TX		CALLAHAN		15.00	40.00	20.00	12.50	18.75	1.00	1.00	1.00	3.00
TX		CARSON		20.00	50.00	35.00	12.50	18.75	1.00	1.00	3.00	5.00
TX		CASTRO		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
TX		COCHRAN		15.00	45.00	25.00	12.50	18.75	1.00	1.00	3.00	5.00
TX		COKE		35.00	150.00	50.00	16.67	18.75	1.00	1.00	3.00	5.00
TX		COLEMAN		20.00	45.00	35.00	12.50	20.00	1.00	1.00	1.00	3.00
TX		COLLINGSWORTH		1.00	30.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
TX		COMANCHE		10.00	30.00	15.00	12.50	18.75	1.00	1.00	1.00	5.00
TX		CONCHO		15.00	100.00	35.00	12.50	18.75	1.00	1.00	3.00	5.00
TX		CORYELL		5.00	5.00	5.00	12.50	12.50	1.00	1.00	3.00	10.00
TX		COTTLE		10.00	25.00	20.00	12.50	12.50	1.00	1.00	5.00	5.00
TX		CRANE		100.00	250.00	175.00	18.75	25.00	1.00	1.00	1.00	3.00
TX		CROCKETT		50.00	300.00	75.00	12.50	25.00	1.00	2.00	1.50	5.00
TX		CROSBY		15.00	45.00	35.00	12.50	18.75	1.00	1.00	3.00	5.00
TX		CULBERSON		10.00	35.00	20.00	12.50	18.75	1.00	1.00	5.00	5.00
TX		DALLAM		1.00	5.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
TX		DAWSON		45.00	95.00	45.00	18.75	25.00	1.00	1.00	3.00	5.00
TX		DEAF SMITH		1.00	15.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
TX		DICKENS		25.00	45.00	25.00	12.50	18.75	1.00	1.00	5.00	5.00

**** REGION #5 WEST TEXAS cont'd ****

State	Sub.	County	Act	Bonus in $$ per Acre Low	High	Most Common	Royalty Range Low%	High%	Rental Range $/Acre/Yr Low	High	Lease Term Years Low	High
TX		DONLEY		1.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
TX		EASTLAND		15.00	40.00	25.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		ECTOR		125.00	250.00	175.00	20.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		EL PASO		10.00	35.00	20.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		ERATH		10.00	25.00	12.50	12.50	18.75	1.00	1.00	2.00	5.00
TX	W/2	FISHER		15.00	75.00	35.00	18.75	20.00	1.00	1.00	1.00	3.00
TX	E/2	FISHER		15.00	35.00	25.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		10.00	35.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		GAINES		45.00	145.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		GARZA		45.00	100.00	70.00	15.75	25.00	1.00	1.00	3.00	3.00
TX		GLASSCOCK	x	100.00	1500.00	175.00	18.75	25.00	1.00	1.00	1.00	3.00
TX		GRAY		15.00	[illegible]	30.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		10.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		1.00	20.00	15.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		HAMILTON		5.00	10.00	7.50	12.50	12.50	1.00	1.00	5.00	10.00
TX		HANSFORD		40.00	75.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	50.00	30.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		HEMPHILL		[illegible]	250.00	225.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		HOCKLEY		25.00	95.00	45.00	12.50	20.00	1.00	1.00	3.00	5.00
TX		HOOD		10.00	25.00	10.00	12.50	18.75	1.00	1.00	1.00	5.00
TX		HOWARD		[illegible]	150.00	100.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		HUDSPETH		10.00	35.00	20.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		HUTCHINSON		[illegible]	50.00	30.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		IRION		35.00	250.00	65.00	[illegible]	25.00	1.00	1.00	1.50	5.00
TX		JEFF DAVIS		10.00	35.00	20.00	12.50	18.75	1.00	1.00	1.00	3.00
TX	E/2	JONES	-*	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX	W/2	JONES	-0	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	45.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		KIMBLE		5.00	35.00	15.00	12.50	16.67	1.00	1.00	5.00	10.00
TX		KING		25.00	45.00	45.00	12.50	18.75	1.00	1.00	3.00	3.00
TX		[illegible]		15.00	45.00	25.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		LAMPASAS		5.00	5.00	5.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		LIPSCOMB		50.00	150.00	125.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX	NW	LIPSCOMB		50.00	350.00	150.00	16.67	20.00	1.00	1.00	2.00	3.00
TX		LOVING		100.00	250.00	175.00	18.75	25.00	1.00	1.00	3.00	3.00
TX		LUBBOCK		45.00	100.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		10.00	25.00	25.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		MARTIN		[illegible]	150.00	100.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		MCCULLOCH		15.00	50.00	25.00	12.50	18.75	1.00	1.00	3.00	7.00
TX		MENARD		5.00	50.00	17.50	12.50	18.75	1.00	1.00	3.00	10.00
TX		MIDLAND		125.00	250.00	175.00	20.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		MILLS		5.00	5.00	5.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	10.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		MITCHELL		50.00	200.00	75.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		MOORE		15.00	40.00	30.00	16.67	18.75	1.00	1.00	3.00	5.00
TX		MOTLEY		10.00	25.00	20.00	12.50	12.50	1.00	1.00	5.00	5.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		NOLAN		25.00	50.00	35.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		OCHILTREE		50.00	125.00	100.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX	NE	OCHILTREE		50.00	300.00	125.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		OLDHAM		1.00	40.00	15.00	12.50	25.00	1.00	1.00	5.00	10.00
TX		PALO PINTO		12.50	35.00	25.00	12.50	18.75	1.00	1.00	3.00	5.00
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		PARKER		25.00	50.00	40.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		PARMER		1.00	5.00	5.00	[illegible]	[illegible]	[illegible]	[illegible]	10.00	10.00
TX		PECOS		125.00	275.00	200.00	20.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX	E/2	POTTER		1.00	10.00	5.00	12.50	18.75	1.00	1.00	10.00	10.00
TX	W/2	POTTER		1.00	10.00	5.00	12.50	18.75	1.00	1.00	[illegible]	10.00
TX		PRESIDIO		10.00	35.00	20.00	[illegible]	[illegible]	[illegible]	[illegible]	10.00	[illegible]
TX		RANDALL		1.00	10.00	5.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		REAGAN		50.00	300.00	75.00	[illegible]	[illegible]	[illegible]	2.00	[illegible]	5.00
TX		REEVES		100.00	250.00	175.00	18.75	25.00	1.00	1.00	1.00	3.00
TX		ROBERTS		25.00	100.00	75.00	12.50	18.75	1.00	1.00	3.00	5.00
TX		RUNNELS		25.00	60.00	40.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		SAN SABA		5.00	5.00	5.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		SCHLEICHER		35.00	200.00	75.00	[illegible]	25.00	[illegible]	[illegible]	[illegible]	[illegible]
TX		SCURRY		45.00	95.00	50.00	18.75	25.00	1.00	1.00	1.00	3.00
TX		SHACKELFORD		15.00	40.00	25.00	16.67	18.75	1.00	1.00	2.00	5.00
TX		SHERMAN		15.00	40.00	25.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		STEPHENS		10.00	50.00	25.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		STERLING		50.00	125.00	75.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		STONEWALL		30.00	125.00	75.00	15.00	25.00	1.00	5.00	1.00	3.00
TX		SUTTON		20.00	150.00	50.00	12.50	25.00	1.00	1.00	3.00	5.00
TX	E/2	SWISHER		[illegible]	50.00	40.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX	W/2	SWISHER		2.00	30.00	10.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		TAYLOR		15.00	[illegible]	25.00	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TX		TERRELL		15.00	250.00	35.00	12.50	25.00	1.00	1.00	3.00	7.00

**** REGION #5 WEST TEXAS cont'd ****

State	Sub.	County	Act	Bonus in $$ per Acre Low	High	Most Common	Royalty Range Low%	High%	Rental $/Acre/Yr Low	Range High	Lease Term Years Low	High
TX		TERRY		25.00	95.00	45.00	12.50	25.00	1.00	1.00	3.00	5.00
TX		THROCKMORTON		10.00	40.00	25.00	12.50	18.75	1.00	1.00	3.00	3.00
TX		TOM GREEN		25.00	100.00	50.00	13.75	25.00	1.00	1.00	3.00	5.00
TX		UPTON		50.00	300.00	75.00	13.57	25.00	1.00	2.00	1.50	5.00
TX		WARD		100.00	250.00	175.00	13.75	25.00	1.00	1.00	1.00	3.00
TX		WHEELER		20.00	300.00	250.00	12.50	18.75	1.00	1.00	3.00	5.00
TX		WINKLER		100.00	250.00	175.00	13.75	25.00	1.00	1.00	1.00	3.00
TX		YOAKUM		45.00	150.00	45.00	12.50	25.00	1.00	1.00	3.00	5.00
		**** REGION #5 MID-CONTINENT ****										
AR		CONWAY		35.00	100.00	75.00	12.50	12.50	1.00	1.00	3.00	5.00
AR		CRAWFORD		15.00	150.00	75.00	12.50	12.50	1.00	1.00	3.00	7.00
AR		FAULKNER		10.00	25.00	17.50	12.50	18.75	1.00	1.00	5.00	5.00
AR		FRANKLIN		25.00	250.00	100.00	12.50	18.75	1.00	1.00	3.00	10.00
AR		JOHNSON	+x*	20.00	200.00	100.00	12.50	12.50	1.00	1.00	3.00	10.00
AR		LEE		3.00	15.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
AR		LOGAN		20.00	250.00	100.00	12.50	12.50	1.00	1.00	3.00	5.00
AR		LONOKE		10.00	25.00	17.50	12.50	12.50	1.00	1.00	5.00	5.00
AR		MADISON		3.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		MISSISSIPPI		3.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		NEWTON		3.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		PERRY		10.00	25.00	17.50	12.50	18.75	1.00	1.00	5.00	5.00
AR		PHILLIPS		3.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		POLK		25.00	50.00	35.00	12.50	12.50	1.00	1.00	5.00	5.00
AR		POPE	+x	35.00	250.00	125.00	12.50	25.00	1.00	1.00	1.00	5.00
AR		PRAIRIE		3.00	12.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		PULASKI		5.00	25.00	25.00	12.50	15.57	1.00	1.00	5.00	10.00
AR		SCOTT		10.00	150.00	50.00	12.50	12.50	1.00	1.00	3.00	10.00
AR		SEBASTIAN		25.00	500.00	100.00	12.50	18.75	1.00	1.00	3.00	10.00
AR		ST.FRANCIS		5.00	30.00	15.00	12.50	15.57	1.00	1.00	5.00	10.00
AR		WASHINGTON		3.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
AR		WHITE		10.00	25.00	17.50	12.50	12.50	1.00	1.00	5.00	5.00
AR		YELL		10.00	150.00	50.00	12.50	12.50	1.00	1.00	3.00	10.00
KS		ALLEN		10.00	10.00	10.00	12.50	12.50	5.00	5.00	3.00	3.00
KS		ANDERSON		10.00	20.00	15.00	12.50	12.50	1.00	1.00	3.00	3.00
KS		ATCHISON		3.00	7.50	5.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		BARBER		15.00	25.00	20.00	12.50	15.57	1.00	1.00	2.00	3.00
KS		BARTON		12.50	20.00	15.00	12.50	12.50	1.00	1.00	3.00	3.00
KS		BOURBON		10.00	10.00	10.00	12.50	12.50	5.00	5.00	3.00	3.00
KS		BROWN		5.00	50.00	10.00	12.50	17.50	1.00	3.00	3.00	5.00
KS		BULTER		12.00	20.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		CHASE		10.00	10.00	10.00	12.50	12.50	5.00	5.00	3.00	3.00
KS		CHAUTAUQUA		10.00	15.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		CHEROKEE		10.00	15.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		CHEYENNE		10.00	20.00	15.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		CLARK		15.00	50.00	20.00	12.50	16.67	1.00	2.00	3.00	3.00
KS		CLAY		10.00	20.00	15.00	12.50	12.50	1.00	1.00	5.00	5.00
KS		CLOUD		10.00	20.00	15.00	12.50	12.50	1.00	1.00	5.00	5.00
KS		COFFEY		10.00	20.00	15.00	12.50	12.50	1.00	1.00	3.00	3.00
KS		COMANCHE		15.00	30.00	20.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		COWLEY		15.00	25.00	20.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		CRAWFORD		10.00	10.00	10.00	12.50	12.50	5.00	5.00	3.00	3.00
KS		DECATUR		10.00	15.00	12.50	12.50	12.50	1.00	1.00	3.00	3.00
KS		DICKINSON		10.00	25.00	15.00	12.50	12.50	1.00	1.00	5.00	5.00
KS		DONIPHAN		2.00	15.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		DOUGLAS		3.00	15.00	5.00	12.50	12.50	1.00	3.00	3.00	5.00
KS		EDWARDS		15.00	25.00	20.00	12.50	15.57	1.00	1.00	2.00	3.00
KS		ELK		10.00	10.00	10.00	12.50	12.50	1.00	5.00	3.00	3.00
KS		ELLIS		10.00	25.00	15.00	12.50	16.67	1.00	1.00	2.00	3.00
KS		ELLSWORTH		10.00	25.00	15.00	12.50	12.50	1.00	1.00	3.00	3.00
KS		FINNEY		15.00	25.00	20.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		FORD		15.00	25.00	20.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		FRANKLIN		5.00	125.00	15.00	12.50	19.00	1.00	3.00	1.00	3.00
KS		GEARY		5.00	15.00	5.00	12.50	12.50	1.00	3.00	1.00	3.00
KS		GOVE		10.00	20.00	15.00	12.50	12.50	1.00	1.00	3.00	3.00
KS		GRAHAM		10.00	20.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		GRANT		15.00	25.00	20.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		GRAY		10.00	25.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		GREELEY		10.00	25.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		GREENWOOD		10.00	10.00	10.00	12.50	12.50	1.00	5.00	3.00	3.00
KS		HAMILTON		15.00	25.00	20.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		HARPER		10.00	25.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		HARVEY		10.00	20.00	15.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		HASKELL		15.00	25.00	20.00	12.50	15.57	1.00	1.00	2.00	3.00
KS		HODGEMAN		10.00	20.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00

**** REGION #6 MID-CONTINENT cont'd ****

State	Sub.	County	Act	* Bonus in $$ per Acre * Low	High	Most Common*	Royalty Range Low%	High%	Rental $/Acre/Yr Low	Range High	Lease Term Years Low	High
KS		JACKSON		10.00	25.00	10.00	12.50	19.00	1.00	3.00	1.00	3.00
KS		JEFFERSON		3.00	15.00	10.00	12.50	12.50	1.00	2.00	3.00	5.00
KS		JEWELL		10.00	20.00	15.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		JOHNSON		5.00	35.00	10.00	12.50	12.50	1.00	2.00	3.00	5.00
KS		KEARNY		15.00	25.00	20.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		KINGMAN		10.00	25.00	25.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		KIOWA		15.00	25.00	20.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		LABETTE		10.00	20.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		LANE		12.50	20.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		LEAVENWORTH		5.00	25.00	10.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		LINCOLN		5.00	5.00	5.00	12.50	12.50	1.00	1.00	5.00	5.00
KS		LINN		10.00	15.00	12.50	12.50	12.50	1.00	1.00	3.00	3.00
KS		LOGAN		10.00	15.00	12.50	12.50	12.50	1.00	1.00	3.00	5.00
KS		LYON		5.00	15.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		MARION		10.00	15.00	12.50	12.50	12.50	1.00	1.00	2.00	5.00
KS		MARSHALL		3.00	15.00	5.00	12.50	12.50	2.00	5.00	1.00	3.00
KS		MCPHERSON		12.50	15.00	12.50	12.50	12.50	1.00	1.00	3.00	5.00
KS		MEADE		20.00	35.00	25.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		MIAMI		5.00	25.00	10.00	12.50	18.50	2.00	5.00	1.00	3.00
KS		MITCHELL		10.00	20.00	15.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		MONTGOMERY		10.00	20.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		MORRIS		5.00	15.00	5.00	12.50	12.50	1.00	2.00	3.00	5.00
KS		MORTON		35.00	50.00	40.00	16.67	18.75	1.00	5.00	3.00	3.00
KS		NEMAHA		5.00	100.00	25.00	12.50	17.50	2.00	5.00	3.00	3.00
KS		NEOSHO		2.00	15.00	10.00	12.50	12.50	1.00	5.00	3.00	3.00
KS		NESS		12.50	25.00	15.00	12.50	16.67	1.00	1.00	2.00	3.00
KS		NORTON		10.00	15.00	15.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		OSAGE		2.00	5.00	2.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		OSBORNE		10.00	15.00	15.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		OTTAWA		10.00	15.00	15.00	12.50	12.50	1.00	1.00	5.00	5.00
KS		PAWNEE		15.00	20.00	17.50	12.50	12.50	1.00	1.00	2.00	3.00
KS		PHILLIPS		10.00	15.00	15.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		POTTAWATOMIE		5.00	5.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		PRATT		15.00	30.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		RAWLINS		10.00	15.00	15.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		RENO		10.00	15.00	12.50	12.50	12.50	1.00	1.00	2.00	3.00
KS		REPUBLIC		10.00	15.00	15.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		RICE		10.00	15.00	12.50	12.50	12.50	1.00	1.00	2.00	3.00
KS		RILEY		2.00	5.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		ROOKS		15.00	20.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		RUSH		15.00	20.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		RUSSELL		15.00	20.00	20.00	12.50	16.67	1.00	1.00	2.00	3.00
KS		SALINE		10.00	15.00	12.50	12.50	12.50	1.00	1.00	3.00	3.00
KS		SCOTT		15.00	25.00	20.00	12.50	12.50	1.00	1.00	3.00	3.00
KS		SEDGWICK		10.00	25.00	15.00	12.50	12.50	1.00	1.00	1.00	3.00
KS		SEWARD		35.00	100.00	50.00	18.75	18.75	1.00	5.00	2.00	3.00
KS		SHAWNEE		2.00	5.00	2.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		SHERIDAN		10.00	15.00	12.50	12.50	12.50	1.00	1.00	3.00	5.00
KS		SHERMAN		10.00	15.00	12.50	12.50	12.50	1.00	1.00	3.00	5.00
KS		SMITH		10.00	15.00	12.50	12.50	12.50	1.00	1.00	3.00	5.00
KS		STAFFORD		10.00	20.00	15.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		STANTON		15.00	25.00	20.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		STEVENS		50.00	125.00	75.00	16.67	20.00	1.00	5.00	2.00	3.00
KS		SUMNER		15.00	30.00	20.00	12.50	12.50	1.00	1.00	2.00	3.00
KS		THOMAS		10.00	15.00	12.50	12.50	12.50	1.00	1.00	3.00	5.00
KS		TREGO		12.50	20.00	15.00	12.50	12.50	1.00	1.00	3.00	3.00
KS		WABAUNSEE		5.00	15.00	10.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		WALLACE		10.00	15.00	12.50	12.50	12.50	1.00	1.00	3.00	5.00
KS		WASHINGTON		10.00	15.00	10.00	12.50	12.50	1.00	1.00	3.00	5.00
KS		WICHITA		10.00	20.00	15.00	12.50	12.50	1.00	1.00	3.00	3.00
KS		WILSON		10.00	10.00	10.00	12.50	12.50	5.00	5.00	3.00	3.00
KS		WOODSON		10.00	10.00	10.00	12.50	12.50	5.00	5.00	3.00	3.00
KS		WYANDOTTE		5.00	15.00	10.00	12.50	12.50	1.00	1.00	3.00	5.00
OK		ADAIR		10.00	25.00	15.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		ALFALFA		50.00	125.00	75.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		ATOKA		10.00	20.00	10.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		BEAVER		100.00	450.00	150.00	12.50	18.75	1.00	1.00	3.00	3.00
OK		BECKHAM		50.00	500.00	500.00	18.75	20.00	1.00	1.00	3.00	3.00
OK		BLAINE		200.00	400.00	250.00	18.75	18.75	1.00	1.00	2.00	3.00
OK		BRYAN		50.00	150.00	75.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		CADDO		200.00	500.00	250.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		CANADIAN		100.00	500.00	200.00	18.75	12.50	1.00	1.00	3.00	5.00
OK		CARTER		75.00	200.00	100.00	18.75	12.50	1.00	1.00	3.00	5.00
OK		CHEROKEE		5.00	15.00	5.00	12.50	16.67	1.00	1.00	5.00	10.00
OK		CHOCTAW		10.00	20.00	15.00	12.50	16.67	1.00	1.00	3.00	10.00

**** REGION #6 MID-CONTINENT cont'd ****

State	Sub.	County	Act	* Bonus in $$ per Acre * *Low	High	Most Common*	Royalty Range Low%	High%	Rental Range $/Acre/Yr Low	High	Lease Term Years Low	High
OK		CIMARRON		25.00	100.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		CLEVELAND		50.00	300.00	200.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		COAL		50.00	150.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		COMANCHE		25.00	300.00	200.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		COTTON		10.00	25.00	15.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		CRAIG		5.00	20.00	10.00	12.50	16.67	1.00	1.00	3.00	10.00
OK		CREEK		35.00	150.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		CUSTER		300.00	600.00	500.00	18.75	20.00	1.00	1.00	3.00	3.00
OK		DEWEY		150.00	350.00	250.00	18.75	18.75	1.00	1.00	2.00	3.00
OK		ELLIS		150.00	400.00	250.00	18.75	18.75	1.00	1.00	5.00	5.00
OK		GARFIELD		25.00	200.00	100.00	12.50	18.75	1.00	1.00	2.00	5.00
OK		GARVIN		75.00	300.00	150.00	12.50	18.75	1.00	1.00	2.00	3.00
OK		GRADY		200.00	1650.00	400.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		GRANT		50.00	150.00	75.00	12.50	18.75	1.00	1.00	3.00	3.00
OK		GREER		25.00	50.00	25.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		HARMON		5.00	25.00	10.00	12.50	16.75	1.00	1.00	3.00	10.00
OK		HARPER		50.00	125.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		HASKELL		50.00	150.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		HUGHES		50.00	150.00	75.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		JACKSON		15.00	25.00	15.00	12.50	18.75	1.00	1.00	3.00	10.00
OK		JEFFERSON		100.00	300.00	150.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		KAY		25.00	200.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		KINGFISHER		50.00	150.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		KIOWA		15.00	30.00	20.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		LATIMER	x	50.00	200.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		LE FLORE		75.00	300.00	125.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		LINCOLN	+x	50.00	150.00	75.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		LOGAN		50.00	200.00	100.00	12.50	18.75	1.00	1.00	2.00	3.00
OK		LOVE		50.00	175.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		MAJOR		50.00	150.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		MARSHALL		50.00	150.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		MAYES		25.00	50.00	30.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		MCCLAIN		50.00	300.00	150.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		MCCURTAIN		10.00	25.00	15.00	12.50	16.67	1.00	1.00	3.00	10.00
OK		MCINTOSH		10.00	25.00	15.00	12.50	16.67	1.00	1.00	3.00	10.00
OK		MURRAY		25.00	50.00	25.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		MUSKOGEE		10.00	25.00	10.00	12.50	18.75	1.00	1.00	3.00	10.00
OK		NOBLE		75.00	200.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		NOWATA		10.00	20.00	10.00	12.50	16.67	1.00	1.00	3.00	5.00
OK		OKFUSKEE		25.00	75.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		OKLAHOMA		75.00	700.00	200.00	18.75	20.00	1.00	1.00	2.00	5.00
OK	SW	OKLAHOMA		250.00	1000.00	400.00	12.50	18.75	1.00	1.00	3.00	3.00
OK		OKMULGEE		25.00	75.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		OTTAWA		5.00	20.00	10.00	12.50	16.67	1.00	1.00	3.00	10.00
OK		PAWNEE		25.00	150.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		PAYNE		35.00	100.00	75.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		PITTSBURG	x	50.00	250.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		PONTOTOC		25.00	50.00	35.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		POTTAWATOMIE		50.00	200.00	75.00	12.50	18.75	1.00	1.00	2.00	5.00
OK		PUSHMATAHA		100.00	200.00	150.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		ROGER MILLS		200.00	800.00	500.00	18.75	20.00	1.00	1.00	2.00	3.00
OK		ROGERS		5.00	25.00	15.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		SEMINOLE		50.00	150.00	75.00	12.50	18.75	1.00	1.00	3.00	3.00
OK		SEQUOYAH		25.00	75.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		STEPHENS		25.00	250.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		TEXAS		75.00	175.00	100.00	12.50	18.75	1.00	1.00	3.00	3.00
OK		TILLMAN		10.00	25.00	20.00	12.50	18.75	1.00	1.00	3.00	10.00
OK		TULSA		25.00	100.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		WAGONER		25.00	50.00	25.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		WASHINGTON		10.00	25.00	15.00	12.50	16.67	1.00	1.00	3.00	10.00
OK		WASHITA		300.00	1000.00	400.00	12.50	18.75	1.00	1.00	2.00	5.00
OK		WOODS		75.00	150.00	75.00	12.50	18.75	1.00	1.00	3.00	5.00
OK		WOODWARD		100.00	375.00	150.00	12.50	18.75	1.00	1.00	3.00	5.00
		**** REGION #7 ROCKY MOUNTAIN ****										
CO		ADAMS		7.00	100.00	25.00	12.50	15.00	1.00	1.00	3.00	5.00
CO		ARAPAHOE		10.00	50.00	25.00	12.50	15.00	1.00	1.00	3.00	5.00
CO		BACA		10.00	50.00	30.00	12.50	18.75	1.00	1.00	3.00	5.00
CO		BENT		10.00	50.00	25.00	12.50	18.75	1.00	1.00	3.00	5.00
CO		BOULDER		5.00	50.00	20.00	12.50	16.67	1.00	1.00	3.00	5.00
CO	CDEL	BOULDER		20.00	100.00	35.00	12.50	15.00	1.00	1.00	3.00	5.00
CO		CHEYENNE		15.00	131.00	45.00	12.50	16.67	1.00	1.00	5.00	10.00
CO		CROWLEY		3.00	15.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		ELBERT		5.00	30.00	13.00	12.50	15.00	1.00	1.00	3.00	10.00
CO		EL PASO		1.00	15.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00

**** REGION #7 ROCKY MOUNTAIN cont'd ****

State	Sub.	County	Act	* Bonus in $$ per Acre * Low	High	Most Common*	Royalty Range Low%	High%	Rental $/Acre/Yr Low	Range High	Lease Term Years Low	High
CO		FREMONT		1.00	10.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		HUERFANO		5.00	15.00	10.00	12.50	15.00	1.00	1.00	5.00	5.00
CO		KIOWA		5.00	125.00	30.00	12.50	12.50	1.00	1.00	5.00	10.00
CO		KIT CARSON		5.00	65.00	25.00	12.50	16.67	1.00	1.00	5.00	10.00
CO		LARIMER		5.00	40.00	20.00	12.50	16.67	1.00	1.00	3.00	10.00
CO		LAS ANIMAS		1.00	5.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		LINCOLN		20.00	245.00	50.00	12.50	16.67	1.00	1.00	3.00	10.00
CO		LOGAN		7.00	51.00	20.00	12.50	15.00	1.00	1.00	3.00	5.00
CO		MORGAN		10.00	75.00	25.00	12.50	16.67	1.00	1.00	3.00	5.00
CO		PHILLIPS		5.00	35.00	15.00	12.50	12.50	1.00	1.00	5.00	10.00
CO		PROWERS		5.00	51.00	20.00	12.50	18.75	1.00	1.00	3.00	5.00
CO		SEDGWICK		5.00	35.00	15.00	12.50	12.50	1.00	1.00	5.00	10.00
CO		WASHINGTON		10.00	46.00	25.00	12.50	16.67	1.00	1.00	3.00	5.00
CO		WELD		10.00	52.00	20.00	12.50	16.67	1.00	1.00	3.00	5.00
CO	CDEL	WELD		25.00	75.00	35.00	15.00	18.75	1.00	1.00	1.50	5.00
CO		YUMA		10.00	45.00	30.00	12.50	16.67	1.00	1.00	3.00	5.00
MT		BEAVERHEAD		2.00	75.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
MT	N2	BIG HORN		5.00	15.00	10.00	12.50	16.67	1.00	1.00	5.00	5.00
MT	S2	BIG HORN		15.00	25.00	15.00	12.50	16.67	1.00	1.00	5.00	5.00
MT		BLAINE		2.00	10.00	3.50	12.50	12.50	1.00	1.00	5.00	10.00
MT		BROADWATER		1.00	15.00	5.00	12.50	12.50	1.00	1.00	5.00	5.00
MT		CARBON		3.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	5.00
MT		CARTER		5.00	20.00	10.00	12.50	12.50	1.00	1.00	7.00	7.00
MT		CHOUTEAU		1.50	5.00	2.50	12.50	12.50	1.00	1.00	10.00	10.00
MT		CUSTER		5.00	10.00	7.50	12.50	12.50	1.00	1.00	7.00	7.00
MT		DANIELS		20.00	100.00	50.00	12.50	16.67	1.00	1.00	3.00	5.00
MT		DAWSON		10.00	200.00	35.00	12.50	16.67	1.00	1.00	3.00	5.00
MT		DEER LODGE	x	2.00	35.00	10.00	12.50	12.50	1.00	1.00	5.00	5.00
MT		FALLON		1.00	75.00	10.00	12.50	16.67	1.00	1.00	5.00	10.00
MT		FERGUS		2.00	15.00	3.50	12.50	12.50	1.00	1.00	7.00	10.00
MT		FLATHEAD		1.50	131.00	30.00	12.50	12.50	1.00	1.00	5.00	10.00
MT		GALLATIN		5.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
MT		GARFIELD		1.00	35.00	5.00	12.50	16.67	1.00	1.00	5.00	10.00
MT		GLACIER		10.00	150.00	25.00	12.50	12.50	1.00	1.00	2.00	5.00
MT		GOLDEN VALLEY		3.00	15.00	5.00	12.50	12.50	1.00	1.00	7.00	7.00
MT		GRANITE		2.00	35.00	10.00	12.50	12.50	1.00	1.00	5.00	5.00
MT		HILL		2.00	7.50	3.50	12.50	12.50	1.00	1.00	5.00	10.00
MT		JUDITH BASIN		1.00	5.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
MT		JEFFERSON		4.00	15.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
MT		LAKE		1.50	20.00	15.00	12.50	16.67	1.00	1.00	5.00	10.00
MT		LEWIS AND CLARK		5.00	210.00	10.00	12.50	12.50	1.00	1.00	10.00	10.00
MT	N2	LIBERTY		3.00	25.00	7.50	12.50	15.00	1.00	1.00	10.00	10.00
MT	S2	LIBERTY		3.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
MT		LINCOLN		5.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	5.00
MT		MADISON		1.00	6.00	10.00	12.50	12.50	1.00	1.00	10.00	10.00
MT		MCCONE		3.00	100.00	20.00	12.50	18.75	1.00	1.00	3.00	5.00
MT		MEAGHER		1.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	5.00
MT		MINERAL		1.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
MT		MISSOULA		5.00	10.00	8.00	12.50	12.50	1.00	1.00	10.00	10.00
MT	N2	MUSSELSHELL		10.00	20.00	15.00	12.50	16.67	1.00	1.00	3.00	3.00
MT	S2	MUSSELSHELL		3.00	6.00	3.00	12.50	12.50	1.00	1.00	5.00	5.00
MT		PARK		10.00	30.00	15.00	12.50	12.50	1.00	1.00	5.00	10.00
MT	N2	PETROLEUM		3.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	7.00
MT	S2	PETROLEUM		5.00	15.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
MT		PHILLIPS		2.00	5.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
MT		PONDERA		4.00	25.00	15.00	12.50	15.00	1.00	1.00	5.00	10.00
MT		POWDER RIVER		5.00	20.00	10.00	12.50	12.50	1.00	1.00	7.00	7.00
MT		POWELL		2.00	35.00	10.00	12.50	12.50	1.00	1.00	5.00	5.00
MT		PRAIRIE		3.00	35.00	15.00	12.50	12.50	1.00	1.00	5.00	10.00
MT		RAVALLI		1.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
MT		RICHLAND	-0	40.00	100.00	50.00	12.50	16.67	1.00	1.00	3.00	5.00
MT		ROOSEVELT	-0	30.00	150.00	90.00	12.50	16.67	1.00	1.00	3.00	5.00
MT	NW	ROSEBUD		10.00	15.00	15.00	16.67	16.67	1.00	1.00	3.00	5.00
MT	REST	ROSEBUD		3.00	10.00	5.00	12.50	12.50	1.00	1.00	7.00	10.00
MT		SANDERS		1.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
MT		SHERIDAN	-0	30.00	150.00	70.00	12.50	16.67	1.00	1.00	3.00	5.00
MT		SILVER BOW		2.00	35.00	10.00	12.50	12.50	1.00	1.00	5.00	5.00
MT		STILLWATER		3.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	5.00
MT		SWEET GRASS		3.00	15.00	5.00	12.50	12.50	1.00	1.00	7.00	10.00
MT	E/2	TETON		2.00	201.00	2.50	12.50	12.50	1.00	1.00	10.00	10.00
MT		TOOLE	x	2.00	75.00	25.00	12.50	12.50	1.00	1.00	5.00	10.00
MT		TREASURE		3.00	10.00	5.00	12.50	12.50	1.00	1.00	7.00	10.00
MT		VALLEY		1.00	450.00	100.00	12.50	25.00	1.00	1.00	1.00	10.00
MT		WHEATLAND		3.00	15.00	5.00	12.50	12.50	1.00	1.00	7.00	10.00
MT		WIBAUX		5.00	200.00	100.00	12.50	16.67	1.00	1.00	3.00	5.00

**** REGION #7 ROCKY MOUNTAIN cont'd ****

State	Sub.	County	Act	* Bonus in $$ per Acre * Low	High	Most Common*	Royalty Range Low%	High%	Rental Range $/Acre/Yr Low	High	Lease Term Years Low	High
MT		YELLOWSTONE		5.00	10.00	7.50	12.50	12.50	1.00	1.00	7.00	12.00
NB		BANNER		5.00	35.00	15.00	12.50	15.00	1.00	1.00	3.00	5.00
NB		CHASE		5.00	35.00	15.00	12.50	15.00	1.00	1.00	5.00	10.00
NB		CHERRY		2.00	7.00	4.00	12.50	12.50	1.00	1.00	10.00	10.00
NB		CHEYENNE		5.00	35.00	15.00	12.50	15.00	1.00	1.00	3.00	5.00
NB		DEUEL		5.00	35.00	15.00	12.50	12.50	1.00	1.00	5.00	10.00
NB	N2	DUNDY		1.00	5.00	2.00	12.50	12.50	1.00	3.00	3.00	5.00
NB	S2	DUNDY		25.00	55.00	35.00	12.50	12.50	1.00	3.00	3.00	5.00
NB		HITCHCOCK		10.00	75.00	20.00	12.50	12.50	1.00	3.00	3.00	5.00
NB		HOOKER		2.00	5.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
NB		KEITH		5.00	35.00	15.00	12.50	15.00	1.00	1.00	5.00	10.00
NB		KIMBALL		15.00	55.00	30.00	12.50	15.00	1.00	1.00	3.00	5.00
NB		MORRILL		5.00	20.00	10.00	12.50	12.50	1.00	1.00	3.00	10.00
NB		NEMAHA		5.00	10.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
NB		OTOE		5.00	5.00	5.00	12.50	12.50	1.00	1.00	3.00	5.00
NB		PERKINS		5.00	35.00	15.00	12.50	15.00	1.00	1.00	5.00	10.00
NB		RICHARDSON		15.00	20.00	15.00	12.50	12.50	1.00	1.00	3.00	3.00
NB		THOMAS		2.00	5.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
ND		ADAMS		5.00	75.00	15.00	12.50	16.67	1.00	1.00	5.00	5.00
ND		BENSON		1.00	2.00	1.00	12.50	12.50	1.00	1.00	5.00	10.00
ND		BILLINGS		15.00	300.00	75.00	12.50	18.75	1.00	1.00	3.00	5.00
ND		BOTTINEAU	-0	15.00	90.00	35.00	12.50	16.67	1.00	1.00	3.00	5.00
ND		BOWMAN		50.00	200.00	75.00	12.50	16.67	1.00	1.00	3.00	5.00
ND		BURKE		5.00	175.00	100.00	12.50	16.67	1.00	1.00	3.00	5.00
ND		BURLEIGH		1.00	5.00	1.00	12.50	12.50	1.00	1.00	7.00	10.00
ND		DIVIDE	-	40.00	250.00	100.00	12.50	16.67	1.00	1.00	3.00	5.00
ND		DUNN		50.00	350.00	150.00	12.50	18.75	1.00	1.00	3.00	5.00
ND		EMMONS		1.00	5.00	1.00	12.50	18.75	1.00	1.00	1.00	5.00
ND		FOSTER		1.00	2.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
ND		GOLDEN VALLEY		25.00	150.00	50.00	12.50	18.75	1.00	1.00	3.00	5.00
ND		GRANT		1.00	25.00	10.00	12.50	16.67	1.00	1.00	5.00	7.00
ND		HETTINGER		1.00	75.00	25.00	12.50	16.67	1.00	1.00	5.00	5.00
ND		KIDDER		1.00	1.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
ND		MCHENRY		2.00	35.00	10.00	12.50	12.50	1.00	1.00	5.00	7.00
ND		MCKENZIE	-	50.00	250.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
ND		MCLEAN	-	15.00	50.00	20.00	12.50	16.67	1.00	1.00	5.00	5.00
ND		MERCER		5.00	75.00	35.00	12.50	16.67	1.00	1.00	5.00	7.00
ND		MORTON		5.00	75.00	25.00	12.50	16.67	1.00	1.00	5.00	5.00
ND		MOUNTRAIL		5.00	100.00	30.00	12.50	18.75	1.00	1.00	3.00	5.00
ND		OLIVER		5.00	35.00	15.00	12.50	16.67	1.00	1.00	5.00	5.00
ND		PIERCE		1.00	3.00	1.00	12.50	12.50	1.00	1.00	5.00	10.00
ND		RENVILLE	+x	15.00	100.00	40.00	12.50	18.75	1.00	1.00	3.00	5.00
ND		ROLETTE		1.00	7.50	2.00	12.50	12.50	1.00	1.00	5.00	10.00
ND		SHERIDAN		1.00	3.00	1.00	12.50	12.50	1.00	1.00	5.00	10.00
ND		SIOUX		1.00	35.00	5.00	12.50	12.50	1.00	1.00	5.00	7.00
ND		SLOPE		25.00	125.00	35.00	12.50	16.67	1.00	1.00	3.00	5.00
ND		STARK		40.00	200.00	75.00	12.50	18.75	1.00	1.00	3.00	5.00
ND		STUTSMAN		1.00	3.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
ND		TOWNER		1.00	1.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
ND		WARD		5.00	50.00	30.00	12.50	16.67	1.00	1.00	5.00	5.00
ND		WELLS		1.00	1.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
ND		WILLIAMS		50.00	300.00	100.00	12.50	18.75	1.00	1.00	3.00	5.00
SD		BENNETT		2.00	5.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
SD		BUTTE		1.00	10.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
SD		CAMPBELL		1.00	5.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
SD		CORSON		1.00	15.00	4.00	12.50	12.50	1.00	1.00	10.00	10.00
SD		DEWEY		1.00	3.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
SD		FALL RIVER		5.00	55.00	20.00	12.50	16.67	1.00	1.00	3.00	10.00
SD	NW4	HARDING		10.00	150.00	35.00	12.50	12.50	1.00	1.00	5.00	10.00
SD	REST	HARDING		1.00	10.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
SD		JONES		2.00	5.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
SD		MEADE		1.00	10.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
SD		PERKINS		1.00	15.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
SD		ZIEBACH		1.00	3.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
WY		ALBANY		3.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
WY		BIG HORN	-	15.00	50.00	25.00	12.50	12.50	1.00	1.00	5.00	10.00
WY		CAMPBELL	x	50.00	275.00	75.00	12.50	17.50	1.00	2.00	3.00	5.00
WY	MINN	CAMPBELL		75.00	733.00	100.00	14.00	18.75	1.00	3.00	1.00	5.00
WY	E2	CARBON		10.00	50.00	25.00	12.50	17.50	1.00	2.00	3.00	5.00
WY	N2	CARBON		20.00	50.00	35.00	12.50	17.50	1.00	3.00	3.00	5.00
WY		CONVERSE		25.00	250.00	50.00	12.50	17.50	1.00	2.00	3.00	5.00
WY		CROOK		15.00	250.00	35.00	12.50	15.00	1.00	2.00	3.00	5.00
WY		FREMONT		15.00	100.00	25.00	12.50	15.00	1.00	1.00	3.00	5.00
WY		GOSHEN		5.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
WY		HOT SPRINGS		10.00	75.00	25.00	12.50	15.00	1.00	1.00	3.00	5.00

**** REGION #7 ROCKY MOUNTAIN cont'd ****

State	Sub.	County	Act	* Bonus in $$ per Acre * *Low	High	Most Common*	Royalty Range Low%	High%	Rental Range $/Acre/Yr Low	High	Lease Term Years Low	High
WY		JOHNSON		15.00	200.00	50.00	12.50	15.00	1.00	2.00	3.00	5.00
WY		LARAMIE		5.00	25.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
WY		LINCOLN		25.00	250.00	75.00	12.50	17.50	1.00	2.00	3.00	5.00
WY		NATRONA		15.00	200.00	30.00	12.50	17.50	1.00	2.00	3.00	5.00
WY		NIOBRARA		15.00	100.00	25.00	12.50	15.00	1.00	2.00	3.00	5.00
WY		PARK		15.00	150.00	25.00	12.50	15.00	1.00	2.00	3.00	5.00
WY		PLATTE		3.00	10.00	5.00	12.50	12.50	1.00	1.00	3.00	10.00
WY		SHERIDAN		15.00	200.00	25.00	12.50	18.75	1.00	1.00	3.00	5.00
WY	FED	SUBLETTE		25.00	150.00	50.00	12.50	17.50	1.00	2.00	3.00	5.00
WY		SWEETWATER		15.00	150.00	25.00	12.50	17.50	1.00	2.00	3.00	5.00
WY		TETON		10.00	100.00	25.00	12.50	15.00	1.00	1.00	5.00	10.00
WY		UINTA	-0	25.00	800.00	75.00	12.50	17.50	1.00	2.00	3.00	5.00
WY		WASHAKIE	-0	15.00	75.00	30.00	12.50	15.00	1.00	1.00	5.00	5.00
WY		WESTON		25.00	100.00	50.00	12.50	17.50	1.00	2.00	3.00	5.00

**** REGION #8 WESTERN ****

State	Sub.	County	Act	*Low	High	Most Common*	Low%	High%	Low	High	Low	High
AZ		COCHISE		5.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
AZ		GRAHAM		5.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
AZ		GREENLEE		5.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
AZ		MARICOPA		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
AZ		MOHAVE		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
AZ		PIMA		5.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
AZ		PINAL		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
AZ		SANTA CRUZ		5.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
AZ		YAVAPAI		1.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
AZ		YUMA		1.00	50.00	5.00	12.50	17.50	1.00	3.00	2.00	10.00
CA		BUTTE		10.00	20.00	10.00	16.67	16.67	10.00	20.00	3.00	5.00
CA		COLUSA		5.00	25.00	20.00	16.67	20.00	5.00	25.00	3.00	5.00
CA		CONTRA COSTA		25.00	100.00	30.00	16.67	22.00	15.00	50.00	2.00	5.00
CA		FRESNO		15.00	20.00	20.00	16.67	16.67	15.00	20.00	3.00	5.00
CA		GLENN		5.00	20.00	10.00	16.67	16.67	5.00	20.00	3.00	5.00
CA		HUMBOLDT		5.00	15.00	10.00	16.67	16.67	5.00	15.00	5.00	5.00
CA		IMPERIAL		5.00	15.00	10.00	12.50	16.67	5.00	15.00	5.00	10.00
CA		KERN		20.00	175.00	25.00	16.67	22.00	20.00	175.00	3.00	5.00
CA		KINGS		10.00	25.00	15.00	16.67	16.67	10.00	25.00	5.00	5.00
CA	LOTS	LOS ANGELES		15.00	50.00	25.00	16.67	20.00	15.00	50.00	3.00	5.00
CA		MADERA		5.00	20.00	10.00	16.67	16.67	5.00	20.00	5.00	5.00
CA		MERCED		10.00	20.00	15.00	16.67	16.67	10.00	20.00	5.00	5.00
CA		MONTEREY		10.00	25.00	20.00	16.67	16.67	10.00	25.00	5.00	5.00
CA		SACRAMENTO		10.00	50.00	20.00	16.67	20.00	10.00	50.00	3.00	5.00
CA		SAN BENITO		5.00	20.00	10.00	16.67	16.67	5.00	20.00	5.00	5.00
CA		SAN BERNADINO		5.00	10.00	5.00	12.50	16.67	5.00	10.00	5.00	10.00
CA		SAN JOAQUIN		10.00	25.00	12.00	16.67	16.67	10.00	25.00	3.00	5.00
CA		SAN LUIS OBISPO		10.00	25.00	15.00	16.67	16.67	10.00	25.00	3.00	5.00
CA		SANTA BARBARA	x	20.00	50.00	25.00	16.67	25.00	10.00	75.00	3.00	5.00
CA		SANTA CRUZ		5.00	10.00	6.00	16.67	16.67	5.00	10.00	5.00	5.00
CA		SOLANO		10.00	50.00	20.00	16.67	20.00	10.00	50.00	3.00	5.00
CA		STANISLAUS		10.00	25.00	15.00	16.67	16.67	10.00	25.00	3.00	5.00
CA		SUTTER		5.00	20.00	10.00	16.67	16.67	5.00	20.00	3.00	5.00
CA		TEHAMA		5.00	20.00	10.00	16.67	16.67	5.00	20.00	3.00	5.00
CA		TULARE		10.00	20.00	15.00	16.67	16.67	10.00	20.00	5.00	5.00
CA		VENTURA		10.00	75.00	25.00	16.67	20.00	10.00	75.00	3.00	5.00
CA		YOLO		10.00	50.00	20.00	16.67	20.00	10.00	50.00	3.00	5.00
CA		YUBA		5.00	20.00	10.00	16.67	16.67	5.00	20.00	3.00	5.00
CO		ALAMOSA		1.00	3.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		CHAFFEE		1.00	2.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		CONEJOS		1.00	2.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		COSTILLA		1.00	2.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		DOLORES		1.00	125.00	35.00	12.50	18.75	1.00	1.00	2.00	10.00
CO		DELTA		1.00	10.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
CO		EAGLE		1.00	4.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		GARFIELD		5.00	50.00	25.00	12.50	16.67	1.00	5.00	5.00	10.00
CO		GRAND		1.00	3.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		GUNNISON		1.00	10.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		HINSDALE		1.00	1.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		JACKSON		1.00	35.00	10.00	12.50	16.67	1.00	1.00	5.00	10.00
CO		LAKE		1.00	1.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		LAPLATA		2.00	110.00	20.00	12.50	16.67	1.00	1.00	5.00	10.00
CO		MESA		2.00	50.00	35.00	12.50	16.67	1.00	5.00	3.00	10.00
CO		MINERAL		1.00	1.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		MOFFAT		1.00	270.00	25.00	12.50	16.67	1.00	1.00	5.00	10.00
CO		MONTEZUMA		1.00	100.00	35.00	12.50	18.75	1.00	5.00	5.00	10.00
CO		MONTROSE		1.00	10.00	3.00	12.50	12.50	1.00	1.00	3.00	10.00
CO		OURAY		1.00	3.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		PITKIN		1.00	25.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00

**** REGION #8 WESTERN cont'd ****

State	Sub.	County	Act	* Bonus in $$ per Acre * *Low	High	Most Common*	Royalty Range Low%	High%	Rental Range $/Acre/Yr Low	High	Lease Term Years Low	High
CO	E/2	RIO BLANCO		5.00	50.00	20.00	12.50	12.50	1.00	1.00	3.00	10.00
CO	W/2	RIO BLANCO		5.00	50.00	25.00	12.50	16.67	1.00	1.00	3.00	10.00
CO		RIO GRANDE		1.00	3.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		ROUTT		1.00	52.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
CO		SAGUACHE		1.00	17.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		SAN JUAN		1.00	1.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
CO		SAN MIGUEL		1.00	15.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
ID		ADA		1.00	5.00	1.00	12.50	12.50	1.00	1.00	5.00	10.00
ID		ADAMS		1.00	1.00	1.00	12.50	12.50	0.50	1.00	10.00	10.00
ID		BANNOCK		2.00	10.00	5.00	12.50	12.50	1.00	1.00	2.00	10.00
ID		BEAR LAKE		25.00	50.00	50.00	12.50	12.50	1.00	1.00	5.00	10.00
ID		BINGHAM		1.00	2.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
ID	FED	BONNER		1.00	1.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
ID		BONNEVILLE		2.00	10.00	4.00	12.50	12.50	1.00	1.00	5.00	10.00
ID	FED	BOUNDARY		0.00	0.00	2.50	12.50	12.50	1.00	3.00	10.00	10.00
ID		BUTTE		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	10.00
ID		CANYON	+x*	1.00	10.00	1.00	12.50	12.50	1.00	1.00	5.00	10.00
ID		CARIBOU		10.00	90.00	55.00	12.50	12.50	1.00	1.00	2.00	10.00
ID		CASSIA		2.00	10.00	5.00	12.50	12.50	1.00	1.00	2.00	10.00
ID		CLARK		10.00	100.00	NO AVG.	12.50	12.50	1.00	1.00	2.00	10.00
ID		FRANKLIN		2.00	55.00	NO AVG.	12.50	12.50	1.00	1.00	2.00	10.00
ID		FREMONT		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	10.00
ID		GEM		1.00	1.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
ID		JEFFERSON		1.00	5.00	3.00	12.50	12.50	1.00	1.00	2.00	10.00
ID		LATAH		2.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
ID		LEMHI		7.50	9.00	7.50	12.50	12.50	1.00	1.00	5.00	5.00
ID		MADISON		1.00	10.00	5.00	12.50	12.50	1.00	1.00	2.00	10.00
ID		NEZ PERCE		2.00	10.00	5.00	12.50	12.50	1.00	1.00	12.00	12.00
ID		ONEIDA		2.00	12.00	5.00	12.50	12.50	1.00	1.00	2.00	12.00
ID		OWYHEE	-0	1.00	1.00	1.00	12.50	12.50	1.00	1.00	2.00	10.00
ID		PAYETTE		1.00	1.00	1.00	12.50	12.50	0.50	0.50	2.00	10.00
ID		POWER		1.00	1.00	1.00	12.50	12.50	0.50	1.00	2.00	10.00
ID	FED	SHOSHONE		1.00	1.00	1.00	12.50	12.50	1.00	1.00	10.00	10.00
ID		TETON		8.00	10.00	10.00	12.50	12.50	1.00	1.00	5.00	5.00
ID		WASHINGTON		1.00	2.00	2.00	12.50	12.50	1.00	1.00	2.00	10.00
NM		GRANT		1.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
NM		HIDALGO		5.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
NM		LUNA		1.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
NV	FED	CHURCHILL		1.00	5.00	1.00	12.50	17.50	1.00	3.00	10.00	10.00
NV	FED	CLARK		2.00	5.00	4.00	12.50	17.50	1.00	3.00	10.00	10.00
NV	FED	ELKO		3.00	10.00	5.00	12.50	17.50	1.00	3.00	10.00	10.00
NV	FED	EUREKA		1.00	10.00	3.00	12.50	17.50	1.00	3.00	10.00	10.00
NV	FED	HUMBOLT		1.00	5.00	1.00	12.50	17.50	1.00	3.00	10.00	10.00
NV	FED	LANDER		1.00	5.00	1.00	12.50	17.50	1.00	3.00	10.00	10.00
NV	FED	LINCOLN		1.00	7.50	5.00	12.50	17.50	1.00	3.00	10.00	10.00
NV	FED	MINERAL		1.00	1.00	1.00	12.50	17.50	1.00	3.00	10.00	10.00
NV	FED	NYE		1.00	30.00	5.00	12.50	17.50	1.00	3.00	10.00	10.00
NV	FED	PERSHING		1.00	5.00	1.00	12.50	17.50	1.00	3.00	10.00	10.00
NV	FED	WHITE PINE		3.00	10.00	5.00	12.50	17.50	1.00	3.00	10.00	10.00
OR		BAKER		1.00	3.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		BENTON		1.00	8.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		CLACKAMAS		2.00	5.00	2.00	12.50	18.75	1.00	2.00	5.00	10.00
OR		CLATSOP		5.00	30.00	20.00	12.50	18.75	1.00	1.00	5.00	10.00
OR	NE	COLUMBIA		5.00	40.00	10.00	12.50	12.50	1.00	10.00	5.00	10.00
OR	NW	COLUMBIA		3.00	15.00	10.00	12.50	18.75	1.00	10.00	3.00	5.00
OR	SE	COLUMBIA		2.00	10.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
OR	SW	COLUMBIA		3.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
OR		COOS		1.00	5.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		CROOK		1.00	8.00	4.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		DESCHUTES		1.00	5.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		DOUGLAS		1.00	5.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		GILLIAM		2.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		GRANT		1.00	3.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		HARNEY		1.00	3.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		HOOD RIVER		1.00	5.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		JACKSON		1.00	3.00	1.50	12.50	12.50	1.00	1.00	10.00	10.00
OR		JEFFERSON		1.00	5.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		JOSEPHINE		1.00	3.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		KLAMATH		1.00	3.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		LAKE		1.00	3.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		LANE		1.00	4.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		LINCOLN		1.00	3.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		LINN		1.00	8.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		MALHEUR		1.00	3.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		MARION		2.00	5.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00

**** REGION #3 WESTERN cont'd ****

State	Sub.	County	Act	* Bonus in $$ per Acre * *Low	High	Most Common*	Royalty Range Low%	High%	Rental $/Acre/Yr Range Low	High	Lease Term Years Low	High
OR		MORROW		2.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		MULTNOMAH		1.00	10.00	5.00	12.50	12.50	PD-UP	PD-UP	5.00	10.00
OR		POLK		1.00	5.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		SHERMAN		3.00	10.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		TILLAMOOK		1.00	6.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		UMATILLA		2.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		UNION		1.00	3.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		WALLOWA		1.00	3.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		WASCO		3.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		WASHINGTON		2.00	10.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		WHEELER		1.00	8.00	4.00	12.50	12.50	1.00	1.00	10.00	10.00
OR		YAMHILL		2.00	10.00	4.00	12.50	12.50	1.00	1.00	10.00	10.00
UT		BEAVER		2.00	5.00	3.00	12.50	12.50	1.00	1.00	5.00	10.00
UT		BOX ELDER		1.00	3.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
UT		CACHE		1.00	15.00	7.50	12.50	12.50	1.00	1.00	5.00	10.00
UT		CARBON		3.50	50.00	20.00	12.50	16.67	1.00	1.00	5.00	7.00
UT		DAGGETT	*x	1.00	30.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
UT		DAVIS		1.00	10.00	7.50	12.50	12.50	1.00	1.00	5.00	10.00
UT		DUCHESNE		35.00	300.00	75.00	12.50	25.00	1.00	5.00	1.00	5.00
UT		EMERY	+x	3.00	25.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
UT		GARFIELD		1.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
UT		GRAND		5.00	150.00	25.00	12.50	18.75	1.00	1.00	2.00	7.00
UT		IRON		3.00	15.00	7.50	12.50	12.50	1.00	1.00	5.00	10.00
UT		JUAB		2.00	15.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
UT		KANE		2.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
UT		MILLARD		1.00	20.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
UT		MORGAN		10.00	100.00	40.00	12.50	16.67	1.00	1.00	5.00	10.00
UT		PIUTE		1.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
UT		RICH		15.00	150.00	50.00	12.50	16.67	1.00	1.00	5.00	10.00
UT		SAN JUAN		2.00	255.00	50.00	12.50	18.75	1.00	1.00	1.00	10.00
UT		SANPETE		10.00	35.00	20.00	12.50	16.67	1.00	1.00	1.00	7.00
UT		SEVIER		5.00	25.00	15.00	12.50	16.67	1.00	1.00	5.00	10.00
UT		SUMMIT	+x	10.00	725.00	100.00	12.50	25.00	1.00	5.00	1.00	7.00
UT		TOOELE		1.00	3.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
UT		UINTAH		10.00	2869.00	75.00	12.50	25.00	1.00	5.00	1.00	5.00
UT		UTAH		10.00	35.00	20.00	12.50	12.50	1.00	1.00	3.00	10.00
UT		WASATCH		10.00	50.00	25.00	12.50	16.67	1.00	1.00	3.00	10.00
UT		WASHINGTON		3.00	15.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
UT		WAYNE		3.00	15.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
UT		WEBER		5.00	20.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00
WA		ADAMS		2.00	6.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		ASOTIN		1.00	3.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		BENTON		5.00	20.00	8.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		CHELAN		2.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		CLALLAM		2.00	12.00	6.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		COLUMBIA		1.00	5.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		COWLITZ		2.00	15.00	7.00	12.50	12.50	1.00	1.00	5.00	10.00
WA		DOUGLAS		2.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		FRANKLIN		3.00	15.00	8.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		GARFIELD		1.00	5.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		GRANT		20.00	175.00	150.00	12.50	18.75	1.00	1.00	5.00	10.00
WA		GRAYS HARBOR		2.00	12.00	2.00	12.50	12.50	1.00	1.00	5.00	10.00
WA		JEFFERSON		2.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
WA		KING		2.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
WA		KITTITAS		20.00	150.00	100.00	12.50	18.75	1.00	1.00	5.00	10.00
WA		KLICKITAT		5.00	20.00	10.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		LEWIS		2.00	3.00	3.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		LINCOLN		2.00	5.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		PACIFIC		2.00	15.00	7.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		PIERCE		2.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
WA		SPOKANE		1.00	5.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		THURSTON		2.00	10.00	5.00	12.50	12.50	1.00	1.00	5.00	10.00
WA		WAHKIAKUM		2.00	15.00	7.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		WALLA WALLA		3.00	10.00	5.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		WHITMAN		1.00	5.00	2.00	12.50	12.50	1.00	1.00	10.00	10.00
WA		YAKIMA		10.00	40.00	10.00	12.50	12.50	1.00	1.00	5.00	10.00

Chairman STARK. Mr. Scoggins, I gather your testimony is on two bills?

Mr. SCOGGINS. Three bills, Mr. Chairman.

Chairman STARK. Have you submitted prepared testimony on this bill?

Mr. SCOGGINS. Yes.

Chairman STARK. I would admonish the witnesses that it is generally appreciated to have the testimony to us the day before the hearing in the interest of helping our staff. I would think it is a courteous way to treat the staff. Without objection, your testimony will be part of the record. You may summarize it or expand on it for 5 minutes.

STATEMENT OF H.B. SCOGGINS, JR., GENERAL COUNSEL, AND VICE PRESIDENT, GOVERNMENTAL RELATIONS, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Mr. SCOGGINS. I appreciate that, Mr. Chairman.

In view of the fact I had three bills to prepare testimony on, we didn't get it completed until last night.

Chairman STARK. That is not an excuse.

Mr. SCOGGINS. I realize that. I agree with everything Mr. Stafford said, and we support his testimony completely.

I would like the record to show that J.R. Ewing is purely a fictional character and not an independent oil producer. I am general counsel for the IPAA, which, together with the 28 unaffiliated organizations listed on the cover of our testimony, represents virtually all the independent producers in the United States as well as many thousands of royalty owners.

H.R. 5022 has been proposed to legislatively overturn the Supreme Court's decision in *Commissioner* v. *Engle*. In that decision, the Supreme Court ruled that lease bonus and advanced royalty payments were eligible at some point during the productive life of an oil and gas property for the deduction of percentage depletion. The Supreme Court did not decide in which year the deduction for depletion would be granted to the lessor and left that determination to be administered by the IRS through regulations.

The Supreme Court's analysis focused on the fact that for nearly 50 years both the courts and the IRS viewed lease bonus and advance royalties as payments in advance for oil and gas to be extracted in the future. As such, lease bonus and advance royalty represent gross income from the property and are subject to the deduction for percentage depletion.

When production was subsequently realized, the lessee was required to amortize the lease bonus payment over the productive life of the property in determining depletable gross income. Advance royalties were excluded from the lessee's gross income for depletion purposes in the year the royalty was paid or when recouped through subsequent production.

These adjustments prevented a double inclusion of the lease bonus or advance royalty payment as depletable gross income by both the lessor and the lessee. If the property is abandoned prior to realization of income, the lessor is required to restore the depletion deduction to income.

The Supreme Court in *Engle* noted that nothing in the legislative history of 613A of the Tax Reduction Act of 1975 indicated that the eligibility of lease bonus and advanced royalty payments for percentage depletion was to be altered by that legislation. Indeed, the overriding purpose of 613A to encourage domestic production and to improve the competitive position of independent and royalty owners vis-a-vis the major integrated companies, was manifested only if the lessor was permitted a deduction for depletion with respect to lease bonus and advanced royalty.

Subsequent to the *Engle* decision, the IRS has published a regulation for implementing the Supreme Court's holding. The guidelines provide safeguards against double counting of depletable income and require restoration of depletion in the event that the property is abandoned prior to realization of production or if advanced royalties are not fully recouped.

The Treasury will not lose any revenue because of that decision. In the event production is realized from the property, the lessee excludes an appropriate portion of the lease bonus or advanced royalty from depletable income to prevent duplicative deductions. If there is no production or production is less than anticipated, the necessary adjustments are made to the lessor's taxable income at the appropriate time. Therefore, tax symmetry in our system is maintained.

To the extent the lessor's percentage depletion exceeds his basis in the property, the excess is an item of tax preference subject to either the alternative minimum tax for individuals or the corporate minimum tax. If an individual is subject to an alternative minimum tax, he receives absolutely no tax benefit for percentage depletion deductions in excess of basis. The corporation is subject to the minimum tax at the rate of 15 percent on percentage depletion in excess of basis.

If the lease expires without production and the percentage depletion is restored to income, a corporate taxpayer is not permitted an adjustment for the minimum tax paid previously on the percentage depletion.

Of much greater significance is the potential harm to our domestic energy supply effort. The severe downturn in the domestic oil and gas industry in the last few years makes the encouragement of exploration and development of our domestic oil and gas resources more important than ever in curbing our dependence on imported energy.

This bill would make acquisition costs for oil and gas leases to develop our resources more expensive for independent producers. This would reduce funds available for drilling and also make some marginal prospects uneconomic to develop. Thus, 5022 is contrary to the goal of increasing domestic oil and gas production and securing our country's energy independence.

Accordingly, the Independent Petroleum Association recommends that H.R. 5022 not be enacted.

Thank you, Mr. Chairman.

Chairman **Stark**. Thank you.

[The prepared statement follows:]

STATEMENT OF H.B. SCOGGINS, JR., GENERAL COUNSEL, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

The Independent Petroleum Association of America (IPAA) is a national organization of some 7,000 independent oil and natural gas producers in every producing area of the United States. IPAA, together with the twenty-nine unaffiliated associations listed on the cover page, represents virtually all independent producers and thousands of royalty owners in the United States. We are grateful for this opportunity to present our views in opposition of H.R. 5022, which would disallow percentage depletion for lease bonuses, advance royalties, and other amounts payable without regard to production from the property. We respectfully request that this statement be made a part of the permanent record of that hearing.

H.R. 5022 has been proposed to legislatively overturn the Supreme Court's decision in *Comm'r* v. *Engle*, (S.Ct., 1984) —— U.S. ——. In that decision, the Supreme Court ruled that lease bonus and advance royalty payments were eligible, at some point during the productive life of an oil or gas property, for the deduction of percentage depletion. The Supreme Court did not decide in which year the deduction for percentage depletion would be granted to the lessor, and left such determination to be administered by the IRS through the promulgation of regulations.

The Supreme Court's analysis focused on the fact that for nearly fifty years, the courts and the Internal Revenue Service (IRS) viewed lease bonus and advance royalties as a payment in advance for oil and gas to be extracted in the future. As such, lease bonus and advance royalty payments represented "gross income from the property" and were subject to the deduction of percentage depletion. When production was subsequently realized, the lessee was required to amortize the lease bonus payment over the productive life of the property in determining depletable gross income. Advance royalties were excludible from the lessee's gross income for percentage depletion purposes in the year the royalty was paid or when such royalty was recouped through subsequent production. These adjustments prevented a double inclusion of the lease bonus or advance royalty payment as depletable gross income by both the lessor and the lessee. If the property was abandoned prior to the realization of income (or if advance royalties were not fully recouped), the lessor was required to restore the depletion deduction to income.

The Supreme Court in *Engle* noted that nothing in the legislative history of Sec. 613A of the Tax Reduction Act of 1975 indicated that the eligibility of lease bonus and advance royalty payments for percentage depletion was to be altered by that legislation. Indeed, the overriding purpose of Sec. 613A of the Tax Reduction Act of 1975, to encourage domestic production and to improve the competitive position of independents and royalty owners vis-a-vis major integrated companies, was manifested, according to the Court, only if the lessor was permitted a deduction for percentage depletion with respect to the lease bonus or advance royalty payment. By permitting the lessor a deduction for percentage depletion with respect to the lease bonus or advance royalty payment, the lessee's acquisition costs were reduced because the lessor's capital was partially returned through percentage depletion.

Subsequent to the *Engle* decision, the IRS has established administrative guidelines for implementing the Supreme Court's holding. The guidelines provide safeguards against double counting of depletable income and require restoration of depletion in the event the property is abandoned prior to realization of production or if advance royalties are not fully recouped. Additionally, the administrative guidelines issued by the IRS implement the statutory requirement that percentage depletion is only available with respect to 1,000 barrels per day average daily production and may not exceed 65% of the lessor's taxable income.

The Supreme Court's decision has had no revenue impact. The Treasury will not lose revenue because of the decision. In the event production is realized from the property, the lessee excludes an appropriate portion of the lease bonus or advance royalty from depletable income to prevent duplicative percentage depletion deductions. If there is no production, or production is less than anticipated, the necessary adjustments to the lessor's taxable income are made at the appropriate time. Tax symmetry in our system is thus maintained. To the extent the lessor's percentage depletion deduction exceeds his basis in the property, the excess is an item of tax preference subject to the alternative minimum tax (individual) or minimum tax (corporation). If an individual is subject to the alternative minimum tax, he receives absolutely no tax benefit for percentage depletion deductions in excess of basis. A corporation is subject to minimum tax at the rate of 15% for percentage depletion deductions in excess of basis. If the lease expires without production and the percentage depletion is restored to income, a corporate taxpayer is not permitted an adjustment for the minimum tax paid in the year the percentage depletion deduction was originally claimed. A corporate taxpayer would thus pay, through the minimum tax computation, for the ability to claim a deduction in advance of production, despite the fact that the deduction never ultimately materializes.

Of much greater significance is the potential harm to our domestic energy supply effort. The severe downturn in the domestic oil and gas industry in the last few years make the encouragement of the exploration and development of our domestic oil and gas natural resources more important than ever in curbing our increasing dependence on imported crude oil and securing energy independence for our nation. H.R. 5022 would make acquisition costs of the oil and gas leases to develop our natural resources more expensive for independent oil and gas producers. This would reduce funds available for drilling and also make some marginal prospects uneconomical to develop. Thus H.R. 5022 is contrary to the goal of increasing domestic oil and gas production and securing our country's energy independence. Accordingly, the IPAA recommends that H.R. 5022 not be enacted.

Chairman STARK. Mr. Stafford, I am not a lawyer either, so let me ask you some nonlawyer questions here, just to get this straight.

When you go out or somebody comes out from the oil company to talk to one of your land owners or the small farmers, and they offer them a bonus, don't they usually offer a bonus of so much per acre?

Mr. STAFFORD. Yes.

Chairman STARK. Now, if the oil company gets Pennsylvania grade crude or watery crude, or whatever, the bonus isn't adjusted later, either way?

Mr. STAFFORD. No, none whatsoever.

Chairman STARK. If the oil company hits a dry hole, the bonus is not returned?

Mr. STAFFORD. No, the bonus is yours. That is why I——

Chairman STARK. If the oil company abandons the property, the bonus is not returned, is it?

Mr. STAFFORD. No, no.

Chairman STARK. So, then, isn't basically a bonus when people do it, just a cash payment, to induce somebody to sign a lease, it is a bounty, it is——

Mr. STAFFORD. It is virtually the only inducement as long as the majority of wells in the nation are dry holes.

Chairman STARK. Now, royalties, on the other hand, just so I understand this, are dealing with a share of the production, and it may deal with the quality and it comes over time. Sometimes the people pay upfront and collect it later or borrow—like a bank in Oklahoma will lend you a whole lot against a little. And the bank of Chicago gets in trouble—I don't quite understand that, I think it is related to charges. But it is something you want to be careful of.

But there is a difference, then, in a royalty which is, as I would characterize as tied to the amount of oil that will come out.

Mr. STAFFORD. Right.

Chairman STARK. Either actually or prospectively, but a bonus is something else. That is a deal between some developer, promoter, or even lease brokers who go out and offer bonuses to get leases and turn around and sell them to somebody else.

Mr. STAFFORD. Right. There is only one other element in there, and that is a delay rental. The bonus is generally paid and thought of as holding the land for 1 year. If it is a 3-year lease, then usually $1 is prepaid and later payments are lumped under the lease, so-called lease bonus.

But, in effect, most people that evaluate this, as you are kind of indicating, it is an option to drill and very much like a surface transaction.

Chairman STARK. Are most leases characteristically renewable for a long time if somebody does drill, or if they add a little money?

Mr. STAFFORD. No, they are held by production.

Chairman STARK. You have to get oil out to keep things going?

Mr. STAFFORD. Right. In some parts of the United States, there are lawsuits going on about very shallow, marginal production holding vast acreages. In Kansas, for example, that is the situation, and in parts of Louisiana, also, where one gas well, that is very shallow that is paying very marginal income. It is being held until the time is right to develop further.

As you know, a great many major oil companies were concentrating overseas, now they are coming back into a great many States, and they have held a great deal of the land from time to time by rather limited production, but the focus is changing.

Chairman STARK. Thank you very much. I appreciate your testimony.

Mr. STAFFORD. Thank you.

Chairman STARK. Next we have a panel of witnesses, Ms. Carole Ann Whittaker, president, Jojoba Growers Association; A. Kelley Shooter, president, Agricultural Investments, Inc.; and Lawrence R. Knowles, senior vice president, Southwest Jojoba Co., Pacific Agricultural Services, Inc.

I would like to welcome all of you to the committee, and, Ms. Whittaker, you may proceed. Unless you prefer to go in some order, of course, I will ask you, Dr. Whittaker, to proceed with your testimony. We have your testimony which will, in its entirety, appear in the record, but you may summarize or add to it in any way you desire.

STATEMENT OF CAROLE ANN WHITTAKER, PRESIDENT, JOJOBA GROWERS ASSOCIATION

Ms. WHITTAKER. Thank you, Mr. Chairman.

From the text which introduces H.R. 5199, it appears clear that the purpose of that bill is to require jojoba farming syndicates to capitalize preproductive costs. The point I make is that the wording of the bill, as proposed, I don't believe will accomplish that purpose.

Chairman STARK. Can't win 'em all, right?

Ms. WHITTAKER. The difficulty is that we are introducing words that have to do with bush and shrub, and jojoba is a bush or shrub. We mention that fruit and nut crops whether or not edible are included and jojoba is inedible, but the difficulty is that it is still not a fruit or nut.

Chairman STARK. I will give you a little extra time, but I just want to ask; there are some experts in your industry who disagree. I just wanted to ask you on that point, this newspaper, Jojoba Happenings, or whatever, is an official publication of the Jojoba Growers Association, is it not?

Ms. WHITTAKER. No, it is not.

Chairman STARK. That is what it says.

Ms. WHITTAKER. It is published in affiliation with the Jojoba Growers Association.

Chairman STARK. It says on the masterhead "Official Publication of the Jojoba Growers Association," official publication.

At any rate, in the January-February issue of, I assume, this year, but there masthead doesn't show it, but in one of the January-February issues on—let me give you the right citation. Take my word, that it is in here, there is a recipe for Billy's jojoba cookies. I will just quote the first few items.

It starts with one-half cups of butter flavored Crisco; three-quarters cups of ground jojoba beans; one-and-a-quarter cups of brown sugar; teaspoon of vanilla; so forth and so on.

Without getting into it—I am a little out of my field—but you cream the Crisco shortening and so forth and so on, and while the cookies are still hot, you remove them—I assume with the ground jojoba beans in there. Now, I can't believe that this newspaper is going to poison its readers, and so I have it on good authority that indeed jojoba beans are edible. I haven't made the cookies yet, but that is my next step.

Ms WHITTAKER. Please don't. [Laughter.]

Mr. Chairman, I don't have editorial control over all the content of the paper, and if you read the next issue of Jojoba Happenings—following the one from which you are quoting—you would see there a letter from Dr. Verbiscar of Anner Biosciences which clarifies that issue and says unequivocally that jojoba is very toxic, the meal is very toxic. There was an article, it was in an article in an issue in 1983, a year and a half ago, in which I likewise made the comment, after an American Oil Chemist Society meeting that jojoba meal is toxic.

There is a little bit of myth that goes along with jojoba in which people have referred to it as being an appetite suppressant, and this is something which has crept into the mythology. It is incorrect.

Chairman STARK. Well, proceed. I just——

Ms. WHITTAKER. Jojoba is most definitely inedible, and I would not suggest you eat jojoba cookies, because cooking the meal makes it more toxic than simply eating the beans.

But the point I am making here, Mr. Chairman, is that if this bill is to pass, it would be better if the bill were clear to everybody.

Chairman STARK. Go right ahead.

Ms. WHITTAKER. Thank you.

Second, I would like to see it clarified that this legislation is new legislation and not a clarification of the 1976 Tax Reform Act, and that is because people, jojoba syndicates, have in good faith taken deductions on preproductive costs and from our indications—you will see attachments there of the testimony given to the IRS—it is simply unclear what the intent of Congress would have been in 1976 had there been any jojoba farming syndicates in existence at the time.

Third, and the most important point, is at this stage of the game, in 1984, does Congress really wish or intend to require jojoba farming syndicates to capitalize preproductive costs? Obviously, the issue you must deal with is to increase revenues for the government. We understand that that is a difficulty.

On the other side, we would implore that you look hard in evaluating jojoba as an industry. It is extremely difficult to commercialize and domesticate new crops. It usually requires something on the order of 100 years to domesticate new crops. In order to do so successfully, it frequently requires government assistance. It requires using tax revenue dollars to commercialize new crops.

I think that it is unheard of for farmers and growers to take on the risks of developing a new crop. We have a very peculiar case here where entrepreneurs, growers, and investors have raised the capital, an immense amount of capital, to establish large-scale plantations, and we have made extraordinary, unheard-of progress in bringing this new crop very, very close to commercialization.

Now, the tax benefits have been helpful and have provided an incentive and reduced the risk to those investors. If these benefits are taken away, it will make our task much more difficult and may well shift the burden and expense of domesticating and commercializing jojoba back onto the Government and back on to tax revenue dollars.

There is quite a bit of background that would lead us to believe that it is the intent of Congress that jojoba should become a commercialized crop. We see it in the Critical Agricultural Materials Act, signed recently by President Reagan. We see three National Academy of Science studies, NSF studies, USDA studies, et cetera, which all lead us to believe that the Nation feels that it is in its interest to domesticate this crop, and I am saying we are doing it in a very cost effective manner.

I believe that that would summarize my points. We thank you very much for this opportunity to make our views known. We would be very happy to conduct onsite tours of plantations for you and your staff members, so you can understand what it is we are doing and trying to do.

Chairman **Stark**. Thank you very much.

[The prepared statement follows:]

Statement of Carole Ann Whittaker, Ph.D., President, the Jojoba Growers Association

From the text introducing H.R. 5199, one would perceive that the purpose of the Bill is to require capitalization of preproductive costs specifically for jojoba farming syndicates. The Bill purports to do so by amending Sec. 278 of the Internal Revenue Code by striking out the words "a grove, orchard or vineyard in which fruit or nuts are grown" and inserting in lieu thereof the words "a grove, orchard, vineyard or other tract of trees, bushes, shrubs, or vines in which fruit or nuts (whether or not edible) are grown."

Jojoba is a bush or shrub and is not edible. However, its seed, which is the crop which is harvested, is not a fruit nor a nut and, therefore, the proposed language of H.R. 5199 still does not include jojoba. The issue of whether jojoba seed is a fruit or nut was argued extensively by expert witnesses in comment letters to the Commissioner of the Internal Revenue Service and in public hearing testimony before an IRS panel regarding proposed regulations for Sec. 278. I refer you to that testimony and have included two papers as exhibits to this text which clearly state that jojoba seed is neither a fruit nor a nut. One paper is authored by a prominent professor of horticulture, the other by the Head of the Fruit Crops Laboratory of the USDA.

I would suggest that if Congress intends to require jojoba farming syndicates to capitalize preproductive costs, the wording of the Bill should either include jojoba specifically or, if it is distasteful to single out a particular crop, then include all agricultural crops. Then the intent of Congress and meaning of the law will be clear to everyone.

Secondly, if H.R. 5199 is passed, it is important that the legislative history makes it clear that H.R. 5199 is enacting a new law and is not an interpretation of the Tax Reform Act of 1976.

Jojoba farming syndicates came into existence in 1979 and have expensed preproductive costs based upon their interpretation that jojoba seed is neither a fruit nor a nut as used in the wording or legislative history of the Tax Reform Act of 1976 relative to IRC Sec. 278. Furthermore, it is unclear what the intent of Congress would have been in 1976 regarding jojoba farming syndicates if there had been any in existence at the time. Again, I refer you to the comment letters and public hearing testimony presented to the Internal Revenue Service and have included those of the Jojoba Growers Association as exhibits to this text.

Thirdly, and most importantly, the question is, Does the Congress really want to require the capitalization of preproductive costs for this new crop which is in its early stages of development?

The commercialization of a new agricultural crop is typically a very lengthy process and frequently requires the support of government and the expenditure of tax revenues to be successful. It is uncommon for private industry and/or farmers to underwrite the cost of agronomic research, product research and formulation, or the development of processing equipment or systems necessary to commercialize a new agricultural crop. I suspect it is unheard of for farmers to undertake large-scale production of a crop for which the market looks promising but is still undeveloped.

There are many reasons why jojoba should be developed as a new commercial agricultural crop. Perhaps the most important of these is that jojoba oil is a unique renewable resource which can be used in important industrial applications. Some of these, particularly as a superior high-temperature, high-pressure lubricant, may result in jojoba oil being designated as a strategic material as that term is defined by the Critial Agricultural Materials Act.

Tax benefits are commonly provided as incentives to taxpayers to undertake the risk of developing resources for this Nation's well-being as exemplified by the tax laws affecting research and development expenditures or oil and gas exploration and development. The deductibility of preproductive costs for jojoba farming syndicates has provided an incentive to taxpayers to invest in jojoba by reducing the level of risk involved and has helped significantly in providing the capital necessary to develop large scale plantations.

In five short years private investors, entrepreneurs and growers have made extraordinary progress in commercializing this new crop—and at very little cost to the government. A continuation or expansion of tax benefits for the development of jojoba would help insure our success. Alternatively, the removal of all tax benefits would make our task more difficult and may shift the financial burden of successfully commercializing jojoba to the U.S. Govenment. Moreover, the enactment of a bill such as H.R. 5199 would appear to contradict the intent of Congress as already expressed in the Critical Agricultural Materials Act.

IS JOJOBA A FRUIT OR A FRUIT CROP?

(By Jules Janick, Ph.D., Department of Horticulture, Purdue University)

The jojoba (*Simmondsia chinensis* Link) Schneider is a shrub native to the Sonoran Desert. The plant produces a liquid wax which may substitute for the oil of the endangered sperm whale. As a result considerable interest by agricultural scientist and entrepreneurs has been focused on the domestication and exploitation of this plant for agricultural use. The question of whether the jojoba "bean" which contains high quantities of the liquid wax is a fruit in the potential sense or whether it can be considered a fruit in the horticultural sense or even in common parlance, or whether the jojoba plant can be considered a fruit crop in agricultural usage has become an issue because of a Technical Advisory Memorandum and a Proposed Regulation Amending Section 278 by the Internal Revenue Department.

The word fruit has various definitions. Webster's International Dictionary (2nd edition) gives 9 definitions (Appendix A).

The word fruit, in an agricultural context has two senses: a botanical meaning referring to a ripened ovary of a seed plant (see definition 8 of Webster) or a horticulural or vernacular meaning which refers to a type of horticultural commodity in the context of fruit, vegetable, nut, or ornamental (see definition 2 of Webster). Other meanings of the word fruit are not germaine because they are literary or obsolete, but are listed as follows:

Definition 1: any product of plant growth as the "fruit of the land";

Definition 3: a course of a meal;
Definition 4: any fruit-bearing plant (obsolete);
Definition 5: the offspring of animals as the "fruit of the womb";
Definition 6: the effect of any action as the "fruits of labor";
Definition 7: British slang for fellow;
Definition 9: a flavor of wine

There are three questions at issue:

(1) Is the jojoba organ, which is harvested for its liquid wax and sometimes referred to as a "bean," a fruit in the botanical sense?

(2) Is the jojoba organ described above a fruit in the horticultural sense or in common parlance as an apple or a strawberry is so considered.

(3) Is the jojoba plant a fruit crop in an agricultural sense and so referred to by agriculturists, agricultural scientists, or plant scientists.

IS THE JOJOBA "BEAN" A BOTANICAL FRUIT?

A current and widely-used text (Helena Curtis. 1983. Biology (4th ed.), Worth Publ., New York) defines fruit and seed as follows:

> *Fruit.*—In angiosperms [seed plants] a mature ripened ovary or group of ovaries and associated structures; contains the seeds.
>
> *Seed.*—A complex organ formed by the maturation of the ovule of seed plants following fertilization; upon germination, a seed develops into a new sporophyte; generally consists of seed coat, embryo, and a food reserve.

This botanical definition is noncontroversial. The essence of the definition is that the botanical fruit is derived from mature ovular tissue which either contains seed or is potentially capable of containing seed.

The botanical seed, a mature ovule is a separate structure produced within the ovary. It usually results from fertilization of an egg cell with a sperm nuclei produced in pollen and is a separate organ within the ovary.

A further description of fruits and seeds that follows is from my horticultural text (Jules Janick. 1979. Horticultural Science (3rd ed.) W.H. Freeman & Co., San Francisco).

The fruit

The botanical term "fruit" refers to the nature ovary and other flower parts associated with it. Thus, it may include the receptacle as well as the withered remnants of the petals, sepals, stamens, and stylar portions of the pistil. It also includes any seeds contained in the ovary.

The structure of the fruit is related to the structure of the flower. Fruits are classified, according to the number of ovaries incorporated in the structure, as simple, aggregate, or multiple fruits. They may also be classified by the nature and structure of the ovary wall; their ability to split apart when ripe (dehiscence), as well as the manner in which this occurs; and the way in which the seed is attached to the ovary.

Simple fruits.-The majority of flowering plants have fruits composed of a single ovary. These are referred to as simple fruits. In [illegible] mature fruit (when the enclosed seed is fully developed) the ovary wall may be [illegible] composed of large portions of living succulent parenchyma) or dry (made up of [illegible]living selerenchyma cells with lignified or suberized walls).

The ovary wall, or pericarp, is composed of three distinct layers. These are, from outer to inner layer, the exocarp, mesocarp, and endocarp. When the entire pericarp of simple fruits is fleshy, the fruit is referred to as a berry (not the same as the horticultural term for the edible portion of some "small fruits"). The tomato, grape, and pepper are berry fruits. The muskmelon is a berry (specifically, a pepo) with a hard rind made up of exocarp and receptable tissue. Citrus fruits are also berries but of a sort called hesperidium: the rind is made up of exocarp and mesocarp, and the edible juicy portion is endocarp.

Simple fleshy fruits having a stony endocarp (such as peach, cherry, plum, and olive) are known as drupes (or stone fruits). The skin of these fruits is the exocarp: the fleshy edible portion is the mesocarp. Simple fleshy fruits in which the inner portion of the pericarp forms a dry paper-like "core" are known as pomes (apple, pear, and quince, for example).

The dry, dehiscent, simple fruits include such types as pods (pea), follicles (milk weed), capsules (jimson weed), or siliques (crucifers). The dry simple fruits that do not dehisce when ripe include achenes (sunflower), caryopses (corn), samaras (maple), schizocarps (carrot), and nuts (walnut).

Aggregate fruits.—Each aggregate fruit is derived from a flower having many pistils on a common receptacle. The individual fruits of the aggregate may be drupes (stony), as in blackberries, or achenes (that is, one-seeded, dry fruits attached to the receptacle at a single point), as in strawberries. In the strawberry, the fleshy edible portion is the receptacle.

Multiple fruits.—Each multiple fruit is derived from many separate but closely clustered flowers. Familiar examples of multiple fruits are the pineapple, fig, and mulberry. The beet "seed," is really a multiple fruit.

The seed

A seed is a miniature plant in an arrested state of development. Most seeds contain a built-in food supply (the orchid seed in an exception). Structurally the seed is a matured ovule, although various parts of the ovary may be incorporated in the seed coat. The miniature plant, or embryo, develops from the union of gametes, or sex cells. By the time the seed is mature, the embryo is differentiated into a rudimentary shoot (plumule), a root (radicle), and one or two specialized seed leaves (cotyledons). A transition zone between the rudimentary root and shoot is known as the hypocotyl.

The stored food is present in seeds as carbohydrates, fats, and proteins. Seeds are thus a rich source of food as well as of fats and oils for industrial purposes. This stored food may be derived from a tissue called the endosperm, which is formed as a result of the fertilization process. The endosperm may produce a specialized region of the mature seed, as in corn, or it may be absorbed by the developing embryo. In the latter case, the cotyledons serve as food-storage organs (for example, as in beans and walnuts).

The following description of fruit and seed of jojoba is taken freely from an authoritative scientific research paper (Scott Gentry. 1958. The natural history of jojoba (*Simmondsia chinensis*) and its cultural aspects. Economic Botany 12(3):261–295).

The jojoba fruit is a capsule, normally dehiscent containing one of three ovules attached to the placenta at the apex of the capsule. The capsule attains nearly full size in about three months. It grows more rapidly than the ovule and within five or six weeks forms a relatively large cavity, which the growing ovule or ovules will gradually occupy. Under good conditions the ovule completely fills the cavity, molding itself to the form and in time as it matures to a well-filled seed may assist in splitting apart the three drying valves of the capsule. Usually only a single ovule develops but 2 or 3 seeded capsules may occur.

The fruit gradually turn from green to tan or brown upon maturation. Upon drying the fruit may or may not split to release the seed.

The large peanut-sized seed of jojoba contain little or no endosperm and consists mainly of the undifferentiated tissue of the cotyledon. At hypogeous germination these become swollen with moisture into large succulent subterranean organs, carrying large reserves of energy for the young plant.

Capsules and seed mature together and under proper conditions the drying capsule splits along the three sutures, the valves falling away from the calyx with any agitation of the bush, as by wind or animals. During the time of seed fall, one can observe seeds and valves in all stages of gradual fall. Frequently, the seed may be seen hanging down from the calyx on its slender placenta, as on a string and will fall at a touch when the placenta has dried. With proper dehiscence the seed falls free upon the ground among the litter of the leaves, twigs, calyces, and valves. When capsules dry prematurely they shrink and may fail to open. If this occurs late enough, the seeds may be viable or otherwise usable, but it is then necessary to crack and shell the capsules.

At maturity most seed are dark brown: size varies from 700 to 5300 seek per kilogram. Cotyledons or seed leaves make up the bulk of the seed and contain about 50% liquid wax.

In conclusion, the jojoba shrub bears a capsular fruit usually containing a single seed. The seed and not the fruit contains the liquid wax. The organ of commerce, sometimes referred to as a "bean" (refer Jerome Smith. 1982. The Super Bean of the Future Part I. Adam Smith Publishing, Metairie, Louisiana) is in fact a seed and not a fruit. The ovular tissue that makes up the fruit is often separated from the seed at harvest.

IS THE JOJOBA SEED A FRUIT IN THE HORTICULTURAL SENSE OR IN COMMON PARLANCE AND IS THE JOJOBA PLANT CONSIDERED A FRUIT CROP?

A fruit crop in the horticultural sense is cultivated either for the botanical fruit or for tissues associated with the botanical fruit as the receptacle in the case of strawberry which is consumed by humans as a food. Further, fruits are usually pulpy and tasteful and usually consumed at the beginning or end of the meal or in-between meals as a snack. Fruit plants are typically woody perennials but there are exceptions such as strawberry and banana. Trees or shrubs bearing edible seeds with a hard shall are known as nuts. For convenience nuts and fruits are often treated together but their distinction as separate kinds of crops is maintained. Thus an authoritative modern textbook (M. N. Westwood 1978 Temperate-zone pomology. W. H. Freeman & Co., San Francisco, Califoirnia) has a chapter entitled Fruit and Nut Species (p. 41) and includes a separate section as "tree nuts" which includes walnut, hickory, filbert, pistachio, and chestnut). The jojoba is *not* included under fruits or nuts.

Edible botanical fruits of herbaceous (nonwoody) plants are usually classed as vegetables. These would include tomato or cucumber. The distinction between fruit and vegetables is not amendable to precise definition but it is clear that many plants whose edible portion is the botanical fruit are considered as vegetables. Common examples are tomato, eggplant, chili peppers, or edible podded legumes as snow peas or string beans.

The distinction between a fruit in the botanical sense and a fruit in the horticultural sense may have legal implications. As a result of a question of impact duties the tomato whose edible portion is a botanical fruit was declared a "vegetable" rather than "fruit" in the common and popular acceptance of such words in the case of Nix et al. v. Hedden (Circuit Court, S.D. New York, May 14, 1889), a decision affirmed by the U.S. Supreme Court (149 U.S. 304) on May 10, 1893.

Although melons are classed as vegetables by horticulturists there is confusion in the public mind if they are fruits or vegetables. The only case of a nonfruit classed as a vegetable in the public mind would be rhubarb whose edible portion is the petiole but is often mistakenly considered a "fruit" because the prepared sause is acid and pulpy as are many fruits. Pomologists, horticulturists who specialize in fruit, never consider rhubarb as a fruit plant.

The question is therefore, whether jojoba, the plant or the seed, is considered a fruit in the "common language of the people or in commerce" jojoba seed is not a fruit in the botanical sense. It is my opinion the jojoba "bean," seed, or plant, is never considered a fruit and to include it as a fruit would twist the English language beyond recognition. The reasons can be summarized as follows:

(1) The useful organ of the jojoba is not a fruit or associated tissue such as a recepticle and thus not considered a fruit in the botanical nor horticulural context.

(2) Although edible, the jojoba is not found in trade in the form of an edible food by the consuming public of the United States and thus not considered a fruit or even a nut in common parlance.

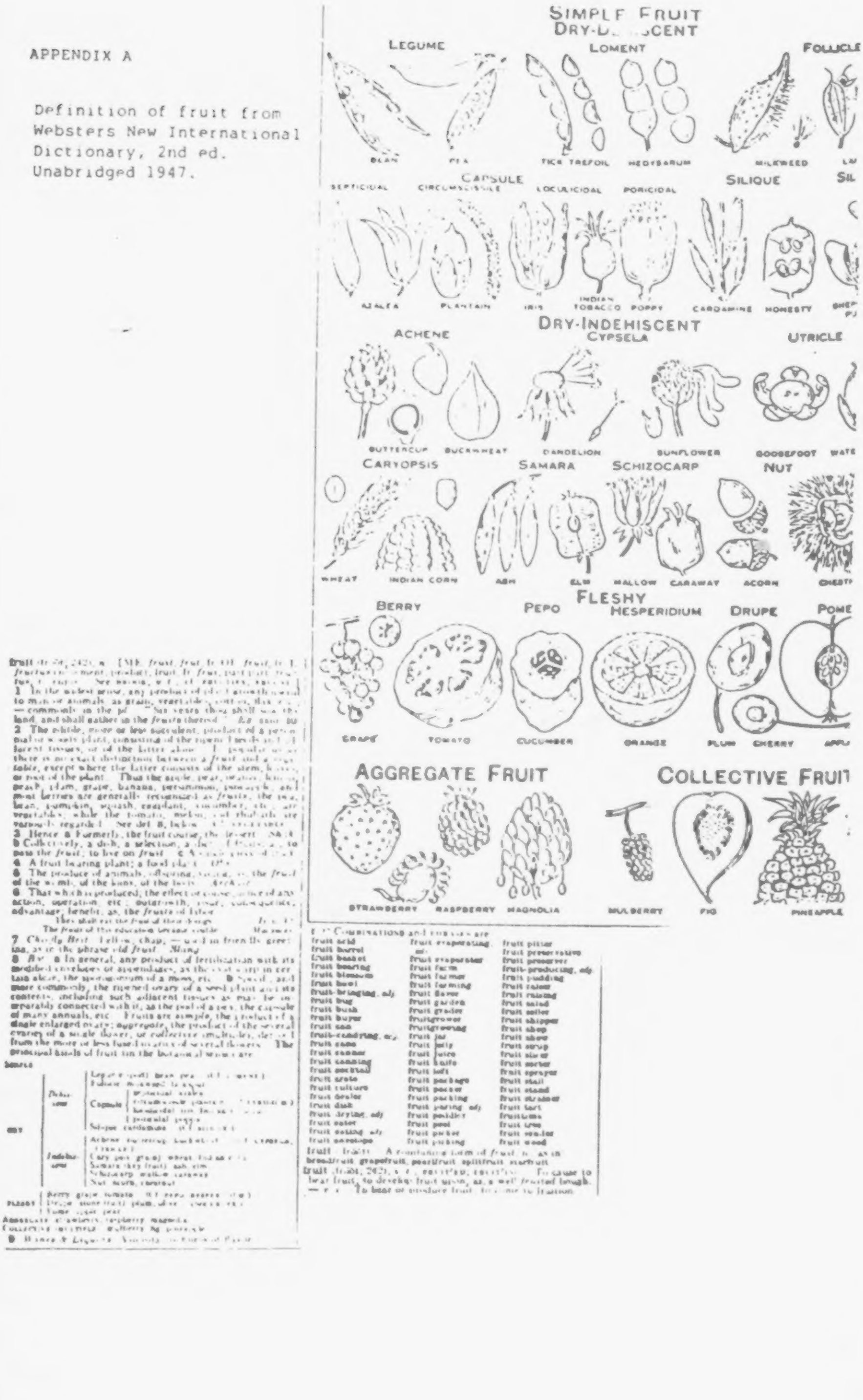
(3) The jojoba is not considered a fruit by pomologists who are specialists in fruit crops in the horticultural sense.

IS THE JOJOBA PLANT A FRUIT CROP IN AN AGRICULTURAL SENSE AND SO REFERRED TO BY AGRICULTURISTS, AGRICULTURAL SCIENTISTS OR PLANT SCIENTISTS?

The National Academy of Sciences published a report entitled "Underexploited Tropical Plants with Promising Economic Value" in 1975. This report includes a study of potential new crops under agricultural groupings that include cereals, roots and tubers, vegetables, fruits, oilseeds, forage and other uses. Jojoba is included in this compilation.

APPENDIX A

Definition of fruit from
Websters New International
Dictionary, 2nd ed.
Unabridged 1947.



Jojoba is not listed as one of the seven species listed under the classification of fruits but is listed as one of the five crops under oilseeds. Therefore, the National Academy of Sciences, the most prestigious scientific group in this country which was chartered by Act of Congress to advise the U.S. Government, considers jojoba an oil seed crop and not a fruit crop.

In this report, the jojoba organ of value is the seed. Four citations from this report follow:

(1) Its [jojoba] seeds contain a liquid "wax" (esters of fatty acid and alcohol) that has impressive industrial potential (p. 105).

(2) Jojoba seeds contain about 50 percent liquid wax (p. 107).

(3) The wax can be obtained in high purity by pressing or by using a solvent to extract the seeds, using conventional oil seed equipment (p. 107).

(4) After the wax has been extracted, the residual *seed* meal contains up to 35 percent protein (p. 107).

An illustration of jojoba seeds is shown on page 106.

CONCLUSION

In my opinion as a horticulturist and plant scientist, I conclude that the jojoba "bean" is a seed and is not a fruit in the botanical sense, the horticultural sense, the agricultural sense, or would be so considered in normal parlance or in trade. The most appropriate term is that the jojoba plant is an oilseed crop, cultivated for its oil-rich seed. Crops in this category would include soybean (*Glycine max* (L.) Merr.), sunflower (*Helianthus annuus* L.), and tung (*Aleurites fordii* Hemsl.).

U.S. DEPARTMENT OF AGRICULTURE,
AGRICULTURAL RESEARCH SERVICE,
NORTHEASTERN REGION, BELTSVILLE AGRICULTURAL RESEARCH CENTER,
Beltsville, MD, March 6, 1984.

JULES JANICK,
Editor, ASHS Editorial Office.
West Lafayette, IN.

DEAR DR. JANICK: This is the answer to your inquiry about the plant commonly called jojoba.

Simmondsia chinensis (Link) called goat nut or jojoba belongs to the Buxaceae family. It is native to the frost-free region of the southwestern U.S. and northern Mexico. It is a horticultural substitute for the ornamental shrub Buxus in arid sites. Its seeds yield the jojoba oil, a substitute to sperm oil. It is well adapted to Arizona and California where plantations exist for oil production. This plant is not considered a fruit or nut by pomologist as the word fruit or nut is used in the horticultural usage.

There is another plant called jujube. This is *Ziziphus jujuba*, a small spring tree. Cultivars of this species have been selected for several thousands years in China. The fruits of jujube are candied, glanced, dried or canned. The fruits are high in sugar and are often called Chinese dates. This species is well adapted to the hot arid valleys of California. This is a fruit tree as a fruit is defined by the horticultural usage of the word. The two plants should not be mixed up.

The usage of the words fruit and nut is not very clear. The usage of these words developed historically. In the development of these words, botanical, production and culinary uses are all mixed up and there is no easy way to classify them.

Botanically fruit is the edible flesh developed around the ovary of the plant from any of the tissues surrounding the ovary; nut is a dry, hard, indehiscent, one-seeded fruit.

Productional use—Fruit and nut production is historically taught or researched in departments of pomology—the science of fruit production. Apples, peaches, blueberries, pineapples and strawberries are fruits; pecans, walnuts, almonds and filberts are nuts.

This is totally inconsistent with the culinary use which in addition to the above, classifies watermelon and cantaloupes as fruits; but cucumbers, tomatoes, peppers as vegetables and peanut as a nut. The productional use classifies watermelon, cantaloupes, cucumbers, tomatoes and peppers as vegetables and peanut as an agronomic crop. The botanical term for all the above are fruit and for peanut as a seed. A nut is an edible kernel enclosed in a woody or leathery shell.

In strawberries, the edible portion is the receptacle on which many "seeds" are located. The strawberry "seed," the achene, is a dry, hard, one-seeded indehiscent fruit which makes it botanically a nut. Therefore, the edible kernel is an important part of culinary definition and distinguishes chestnut which is edible from horse chestnut which is not.

If this terminology is carried to extremes than any plant producing edible botanical fruits should be fruits; sunflower seed or squash seed eaten as nuts should be nuts; since there is no difference botanically between peach and almond and some people eat peach seed, peach could be a nut and almond a fruit. There are obviously rediculous outtakes in the usage of the language. One cannot make rules about the useage of these words. The language has developed this way and should be accepted as such.

Returning to jojoba, it can be stated that at present it is not in the responsibility of "pomology" and not even in Horticulture. The person who is most responsible for the development of jojoba as an oil crop is Dr. D. M. Yermanos, Professor of Agronomy, Botany and Plant Science Department, University of California, Riverside, California. Within the USDA Agricultural Research Service, the overseeing of this research belongs to Dr. Quentin Jones who is the germplasm and new crop specialist and not to Dr. Howard Brooks who is the overseer of the horticultural-pomology research. It appears that the botanical terminology in this care cannot be used, and since jojoba is an oil crop, the culinary terminology clearly reflects that it is a "goat-nut" and is not a "nut" for human consumption.

I am sorry that my answer is somewhat confusing but in order to give you all the details, I felt I must go into complicated reasoning.

With best regard.

Sincerely,

MIKLOS FAUST,
Chief, Fruit Laboratory,
Horticultural Science Institute.

THE JOJOBA GROWERS ASSOCIATION,
Phoenix, AZ, January 4, 1984.

COMMISSIONER OF INTERNAL REVENUE,
Internal Revenue Service,
Washington, DC.

DEAR SIR: We are writing in regard to proposed Internal Revenue Service Regulations on Farming Syndicate Expenditures filed November 14, 1983, and published in the Federal Register on November 15, 1983, pp. 51936–51940.

The Jojoba Growers Association is a professional organization founded in 1980 to serve the needs and concerns of the jojoba industry. Its membership is made up of jojoba growers, processors, researchers and others interested in the progress of jojoba. The membership of the Association represents approximately 25,000 acres of the estimated 30,000 acres of jojoba under cultivation in the United States.

The proposed Internal Revenue Service Regulations on Farming Syndicate Expenditures would make changes in the meaning of the words "fruit", "orchard" and "grove" as used in Code Section 278(b) which would require jojoba farming syndicates to capitalize all preproductive costs. It is our contention that these changes, in effect, amend and expand the statute as given in the 1976 Tax Reform Act and that this action is not within the authority of the Internal Revenue Service but, rather, that of Congress.

Legislative history of code section 278

Code Section 278 was introduced in 1969 to require a taxpayer to capitalize the costs of planting, cultivation, maintenance or development of any citrus grove for four years. The Code was amended in 1971 to include almond groves.

The committee reports regarding Section 278 reveal that Congress wished to prevent taxpayers from sheltering income by taking losses against ordinary income during the developmental period of citrus and almond groves and converting ordinary income to long term capital gain upon the sale of the grove. Secondarily, Congress wished to protect these agricultural industries from the results of overproduction.

During the 1960's these were very real concerns. Many thousands of acres of citrus were developed in suburban areas lying in the path of urban expansion, particularly southern California and Florida. Taxpayers would develop groves and offset ordinary income from other sources against the developmental cost of the grove. As nearby urban areas expanded, the groves would be sold for the increased value of the land and the taxpayer would realize long term capital gain income. The crops from groves developed in this manner frequently had little economic value and the resulting overproduction was adversely affecting the market for citrus and almonds. The enactment and 1971 amendment of Code Section 278 was supported by farmers seriously engaged in growing citrus and almonds.

The Tax Reform Act of 1976 made changes in Section 278 which required farming syndicates (as defined in Section 464(c)) engaged in planting, cultivating, maintaining or developing a grove, orchard or vineyard in which fruit or nuts are grown to capitalize all amounts attributable to planting, cultivation, maintenance and development until the taxable year in which a grove, orchard or vineyard bears a crop in commercial quantities.

The legislative history of the Tax Reform Act of 1976 (P.L. 94–455) gives the reasons for changing Sections 278 and 464 of the Code regarding farming syndicates. During the period from 1970 to 1975, "the number and volume of publicly syndicated investments in almost all areas of agriculture increased substantially. Farm tax benefits were packaged and sold to high-bracket taxpayers through limited partnerships and management contracts for investment in cattle feeding and breeding, tree crops, vegetable and other field crops, vineyards, cows, fish, chickens and egg production." [Cf. Senate Finance Committee Report, S. Rept. No. 94–938, 94th Congress, 2nd Sess. (June 10, 1976) p. 54] These investment programs enabled taxpayers to utilize farm tax rules to effectively defer or defer and shelter taxes.

The committee report states that "the special farm tax rules should be continued for most farmers who are actively engaged in farm operations, but that such special farm tax rules should be severely curtailed for farming syndicates in which a substantial portion of the interest is held by taxpayers who are motivated, in very large part, by a desire to shelter other income, rather than by a desire to make a profit in the particular farming operation. The committee believes that reducing tax incentives for high-bracket taxpayers who invest in syndicated farming operations will improve the competitive position of full-time farmers who must look to the income generated from farm operations for all or most of the return on their investment in farm operations." (p. 58)

The term "farming" was "defined broadly to mean cultivation of land or the raising or harvesting of any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training, and management of animals. Thus, for example, a syndicate engaged in the raising of fish, poultry, bees, dogs, flowers, vegetables, etc., as well as livestock is engaged in farming and, thus, is a farming syndicate." (p. 60)

The committee amended Code Section 464 to require the capitalization of feed, seed, fertilizer and other supplies until consumed and the costs of acquiring poultry. Taxpayers engaged in farming were already required to inventory, and therefore capitalize the cost of, livestock held for sale. No specific changes were made for fish, bees or dogs.

The committee also amended Section 278 to require farming syndicates to capitalize preproductive costs for groves, orchards or vineyards in which fruit or nuts are grown. No specific changes were made affecting the farming of flowers or vegetables.

History of the development of jojoba as an agricultural industry

Simmondsia chinensis, commonly known a jojoba, is a native desert plant indigenous to the Sonoran Desert. Studies on jojoba, its cultivation and the properties of its oil have been conducted for many years by the Boyce Thompson Arboretum and the University of Arizona in its Department of Plant Sciences and Office of Arid Lands Studies; the University of California at Riverside; the University of Sonora at Hermosillo, Mexico; the Ben Gurion University of the Negev at Beer Sheva, Israel; and the U.S. Department of Agriculture, among others.

In 1977, the National Academy of Sciences concluded that 150,000 acres of jojoba would be required to meet the U.S. demand for potential uses primarily in lubricants, cosmetics, and pharmaceuticals. More recently, Bill H.R. 2733, the Critical Agricultural Materials Act, was introduced to the 98th Congress. In the Bill, jojoba is listed specifically as a strategic material, meaning critical to defense, because of its similarity to sperm whale oil. The development of jojoba, among other agricultural products, is viewed as a benefit to the economy, the defense and the general well-being of the Nation.

Although international conferences on jojoba have been held since 1972, it was not until 1978 that substantial interest was aroused in growing jojoba on a commercial basis. This interest was due, in large part, to the 1972 U.S. embargo on sperm whale oil, the publication in 1977 by the National Research Council of the National Academy of Sciences of a feasibility study on the production of jojoba, and the dramatic increases in the price of petroleum in the late 1970's.

Based upon the large potential market for jojoba oil. businessmen, farmers, entrepreneurs and investors have seen an opportunity to develop an important renewable resource and make a significant return on their investment of capital and effort. The successful production of jojoba as an agricultural commodity, however, requires the domestication of a native plant including the determination of methods for planting, cultivating, harvesting and processing of jojoba as well as the identification and propagation of superior cultivars. The establishment of jojoba oil as a renewable resource requires not only a stable and predictable level of production but also a significant amount of product research and formulation to stimulate the use of jojoba in lieu of currently used materials.

Recognizing the risk in developing a crop whose yields under cultivation are unknown and for which no market is yet established, banks and other financial institutions have steadfastly refused financing for the development of jojoba plantations, both to established farmers as well as outside investors. Therefore, virtually all of the jojoba under cultivation in the U.S. today has been financed by individual private investors.

Investors have been willing to invest their money in this high-risk venture primarily of the potentially high return on investment. Recognizing the risk involved and the lengthy period required for development and, consequently, for any return on investment, developers and promoters have tried to utilize whatever tax benefits are available to reduce part of the risk to the private investor.

The first commercial jojoba plantations were planted in the summer of 1978. Since then, approximately 30,000 acres of jojoba have been planted in the U.S. The first commerical yields were achieved on several hundred acres in 1982. Estimates of the number of acres planted, by year, and of expected production are given in Tables I and II below. These figures were committed as a result of a survey of jojoba growers conducted by the Jojoba Growers Association in 1982.

TABLE I.—JOJOBA ACREAGE BY PLANTING YEAR

1978	300
1779	2,200
1980	4,600
1981	7,500
1982	8,700
1983 (estimated)	3,200
Unspecified	3,500
Total (estimated)	30,000

TABLE II.—ESTIMATED PRODUCTION FROM 1978–82 PLANTINGS

Year	Seed, tons	Oil, gallons
1983	100	14,000
1984	500	63,500
1985	1,800	246,000
1986	4,700	644,000
1987	9,300	1,274,000
1988	15,500	2,123,000
1989	22,100	3,027,000
1990	28,000	3,836,000

The capital required to develop these plantations has come from individual farmers and investors, farming syndicates and research and development partnerships. Capital is frequently contributed over a period of several years since it requires five to six years for a plantation to achieve sufficient profitability to give a return on investment.

Farming syndicates engaged in developing jojoba plantations usually expense all of their farming costs from the time of planting until commercial production is achieved. Costs of acquiring and developing land, purchasing propagating stock, and planting are capitalized just as they would be for an individual farmer. Depending upon the structure of a given investment program and the manner in which losses are allocated, an investor may deduct 60 to 100 percent of his investment as a taxable loss. This has been a strong incentive in attracting private investment capital to the development of jojoba.

Jojoba farming syndicates and code section 278

Section 278 of the Internal Revenue Code specifies that farming syndicates engaged in planting, cultivating, maintaining, or developing a grove, orchard or vineyard in which fruit or nuts are grown must capitalize all preproductive costs. It has been the widespread understanding among jojoba growers that jojoba seeds are neither fruits nor nuts but rather seeds or beans, and that the farming of jojoba was unaffected by section 278 of the Internal Revenue Code.

The definition of "fruit" and "nut" differ according to whether the scientific or common usage definitions are used. In its proposed regulations, the Internal Revenue Service is attempting to include jojoba by giving the botanical definition of "fruit" as a "fertilized and developed ovary of a plant, including the seeds, or in the case of a plant that does not bear seeds, the fertile structure of the plant," rather than the common usage definition of "a sweet and edible plant structure usually eaten raw or as a dessert such as peaches, pears, grapes, citrus, or apples (Webster's)."

The botanical definition given in the proposed regulations would include all fruit, nut, vegetable and seed crops whether edible or not. Cotton, artichokes, soy beans, asparagus, castor beans and grain crops would be "fruits" as well as apples, pears, peaches and avocados.

The terms "orchard" and "grove" are not scientific terms but are defined in dictionaries as "a group of trees in which fruit or nuts are grown." The jojoba plant is clearly not a tree, which is a single-stemmed plant, but a shrub or bush, which is a multi-stemmed plant. The inclusion of shrubs and bushes in the definition of "grove" or "orchard" gives entirely new meaning to the terms.

Had the scientific meaning of "fruit" been intended by Section 278(b), the use of the word "nut" would be redundant since all nuts are fruits under the scientific definition. The use of the terms "orchard" and "grove" also become redundant if they include shrubs and bushes. With the new definitions given by the proposed regulations, virtually all field crops become "fruit groves."

The statement of Code Section 278(b) is brieef and contains only the key descriptive terms "grove, orchard or vineyard in which fruit or nuts are grown." No qualifying descriptions, definitions or examples are given in the regulation.

The Senate Finance Committee report for the Tax Reform Act of 1976, however, discusses farming syndicates in detail. It is clear from the context in which the words are used that the common use meanings of "fruit", "nut", "orchard" and "grove" are intended since they are distinguished from "vegetables" and "field crops." For example, on page 57 of the Committee report, the statement is made that "an investment in an orchard, vineyard or grove involves a 'tree crop' as distinct from a 'field crop' such as vegetables. The list of tree crop partnerships covers virtually anything grown in an orchard or vineyard in the form of trees or vines which provide annual crops of fruits (e.g. grapes, apples or avocados) or nuts (e.g. pecans, pistachios or walnuts)."

It is our understanding that the Service requested and received a definition of the word "fruit" from a staff member of the U.S. Department of Agriculture and it is this definition which is included in the proposed changes in Section 278. Such definition is, of course, correct and does include jojoba seed. It is not, however, the meaning as used in the context of the current regulation nor of the accompanying Senate Finance Committee reports.

The Jojoba Growers Association has requested that several experts in agriculture and plant sciences define "fruit" and "nut" in the context in which they are used in the regulation and give their opinions as to whether jojoba is included in their meaning. It is quite clear that jojoba seed is neither a "fruit" nor a "nut" nor is the plant grown in an "orchard" or "grove" when the common use of these words is implied. Copies of the responses from these experts are attached as Exhibit A.

We recognize that the Commissioner of Internal Revenue has broad authority to promulgate all necessary regulations, and that Treasury regulations should be sustained unless they are "unreasonable and plainly inconsistent with the revenue statutes." *Commissioner* v. *South Lumber Co.*, 333 U.S. 496, 501 (1948). However, even though regulations are entitled to considerable weight, the Commissioner of Internal Revenue may not usurp the authority of Congress by impermissibly expanding or restricting any provision of the Internal Revenue Code. *Estate of Boeshore* v. *Commissioner*, 78 T.C. 523, 527 (1982). See *State of Washington* v. *Commissioner*, 77 T.C. 656 (1981), aff'd 692 F.2d 128 (D.C. Cir. 1982). A regulation is not a reasonable statutory interpretation unless it harmonizes with the plan language, origin and purpose of the statute. *United States* v. *Vogel Fertilizer Co.*, 455 U.S. 16 (1982); *Durbin Paper Stock Co.* v. *Commissioner*, 80 T.C. 252, 257 (1983).

Given the fact that jojoba was not included in the provisions of Section 278(b), as effected by the Tax Reform Act of 1976, and that the legislation history and better reasoned construction of Section 278(b) support the common use meanings of "fruit", "nut", "orchard" and "grove", the inclusion of jojoba within the statutory framework of Section 278(b) by Proposed Regulation 1.278-2 is, in effect, an amendment which expands the applicability of the statute. The Commissioner of Internal Revenue does not have this authority to change the statute by regulation. Where the statute's provisions are unambiguous and its directive specific, the Commissioner has no power to amend it by regulation. *Koshland* v. *Helvering*, 298 U.S. 441, 447 (1936); *Arrow Fastener Co.* v. *Commissioner*, 76 T.C. 423 (1981). The power to amend or enact legislation rests solely within the province of Congress.

Intent of Congress regarding Jojoba and section 278

It has been unclear to all parties concerned, including jojoba farming syndicators and their tax counsels, whether Congress would have included jojoba specifically in Section 278 in 1976 had there been any jojoba farming syndicates in existence at the time. Were jojoba farming syndicates left out unintentionally merely because they were unknown?

It was clearly the intent of Congress to prevent non-farmer, outside investors from using farm tax rules to defer or shelter taxes. Investors in jojoba farming syndicates do defer taxes during the preproductive period. However, there is little likelihood that jojoba investors will convert ordinary income to long term capital gain since virtually all jojoba plantations are located in very rural desert areas where there is no appreciation in land values due to urban expansion.

In 1976 Congress was concerned over the adverse effects that farming syndicates were having on farmers. There is little relevance to jojoba in this regard since few farmers can afford to develop jojoba plantations on their own nor can they obtain funds from financial institutions to do so. On the contrary, jojoba farming syndicates have given some farmers additional income in the way of management contracts or in the lease or sale of their lands.

It is possible that Congress may wish not only to exclude jojoba farming syndicates from Section 278 but also to give special incentives to develop jojoba, which is listed in the Critical Agricultural Materials Act (H.R. 2733). Under the terms of the Act, which has passed in the House of Representatives and is currently before the Senate, federal funds would be allocated to the research and development of jojoba as well as guayule and other native plants. These new crops are viewed as potential sources for strategic and essential materials if they can be domesticated and grown commercially. Tax incentives for non-farmer investors may prove more cost effective in developing jojoba than the allocation of federal funds. It would appear that the current action by the Internal Revenue Service to claim that jojoba is included in Section 278(b) is in direct contradiction to the intent of Congress. We believe that the Service is in error and should relegate the matter to the Congress for legislation.

Economic viability of jojoba

We have heard reports that some members of the IRS staff have expressed surprise that jojoba has any economic substance or potential. It is evidently the opinion of some IRS staff members that jojoba is a sham investment scheme designed to allow taxpayers to avoid taxes.

There is abudant evidence available showing the economic potential of jojoba. The National Research Council of the National Academy of Sciences published reports in 1975 and 1977 on the feasibility of developing jojoba as an agricultural crop on native Indian lands. These reports contain estimates of the potential market value and price for jojoba oil. Market analyses and feasibility studies have been conducted by the Office of Arid Lands Studies in conjunction with the Midwest Research Institute under a grant from the National Science Foundation, and by the United Nations Industrial Development Organization (UNIDO). Private, and proprietary, market studies have been conducted by the University of California at Riverside, and by Experience, Inc. and other private agri-business consulting firms. Copies of the public studies are attached as Exhibit B.

As further evidence of the seriousness with which jojoba is regarded is the publication of the journal *Jojoba Happenings* since 1972 by the Office of Arid Lands Studies at the University of Arizona. There have been five international conferences on jojoba held since 1972 for which proceedings have been published.

The American Oil Chemists' Society published a feature article on jojoba in the January, 1983, issue of their professional journal. A symposium on jojoba was presented at the annual meeting of the American Oil Chemists' Society in May, 1983, and at a national symposium in conjunction with the 75th annual meetings of the Crop Science Society of America, American Society of Agronomy, and the Soil Science Society of America in August, 1983. The U.S. Department of Agriculture has conducted research on jojoba for over 25 years. Some sample references are given in Exhibit C.

The ultimate economic viability of jojoba will not be known until the jojoba industry can provide adequate and stable supplies of jojoba oil at reasonably competitive prices. However, the involvement and professional organizations referred to above show the interest in the potential economic value of jojoba which has prompted the infusion of private investment capital for its development.

Effect of the proposed regulations

During the period from 1978 to 1983, approximately 30,000 acres of jojoba plantations have been developed in the U.S. It requires $5,000 to $8,000 per acre over a period of five to six years to reach profitable production. These funds are spent on labor, machinery and equipment, fertilizer and other chemicals, utilities and housing. Approximately $200 million have been committed or spent to date by jojoba developers and have gone toward creating jobs, supporting service industries and improving land. As jojoba comes into production, the development and operation of processing plants and the creation of taxble profits will contribute even more to the economy of the Nation.

If all of the jojoba acreage developed to date were funded by farming syndicates (which it is not) which deduct an average of 75 percent of their investment, the total amount of tax deductions by jojoba investors would amount to $150 million over a period of six years. If the jojoba is successful, the 30,000 acres developed today are expected to generate at least $60 million of taxable income to investors annually!

If the IRS is successful in requiring jojoba farming syndicates to capitalize all preproductive costs, the financing of jojoba development by the private investment sector will be severely curtailed, if not stopped altogether. Little or no additional acreage will be developed unless or until the government or large corporations make a commitment to developing jojoba. Existing plantations may be adversely affected if investor/owners withdrew their ongoing financial support.

A discontinuity in the production of jojoba oil at this time will seriously affect the development of the market for oil by creating further instability in supplies and reducing the credibility of jojoba in the view of user industries as a legitimate and reliable agricultural industry. A new industry capable of providing a valuable renewable resource for the Nation's well-being and economy, developed in the American tradition by entrepreneurs and individuals, supported in part by tax dollars within the true intent of Congress to stimulate industries beneficial to the Nation, may well be stopped dead in its tracks!

Tax shelters and tax shelter abuse

The Jojoba Growers Association acknowledges that there may be some apparent tax shelter abuses in various jojoba investment programs. A small number of jojoba promoters have received disproportionate notoriety from the media with the result that some view the jojoba industry as nothing more than an attempt on the part of aggressive promoters to sell worthless desert land to unsuspecting investors.

Furthermore, the Jojoba Growers Association realizes that the Internal Revenue Service has a mandate to aggressively pursue unethical and abusive tax shelters.

It is common knowledge that there are abusive tax shelter programs among viable investments in other areas such as oil and gas, real estate, equipment leasing or research and development which are supported by legal tax incentives. The abusiveness of such tax shelters usually stems from their lack of compliance with at-risk rules, the overvaluation of products purchased or lack of any economic return. To the extent that a given jojoba investment program constitutes an abusive shelter, deductions can very likely be disallowed on the basis of lack of compliance with the general guidelines of the Internal Revenue Code. It is not necessary, and counterproductive to the development of the jojoba industry, to close off an important source of capital by including jojoba in Section 278(b) of the Code.

Summary and conclusion

The Jojoba Growers Association, its members and tax counsel, contend that the Service is in error with regard to its interpretation of the terms "fruit", "orchard" and "grove" as used in Section 278(b) of the Internal Revenue Code. The proposed regulations, therefore, constitute an amendment and expansion of the statute which is not within the authority or jurisdiction of the Service. We request that the proposed regulations 1.278-2 be withdrawn immediately.

The Jojoba Association formally requests a public hearing in regard to this matter unless the proposed regulations are withdrawn as a result of the Service's evaluation of our written comments. It is intended that Dr. Carole A. Whittaker and David R. Bosse, President and tax counsel for the Association, respectively, will appear at such hearing. In addition, the Association may present oral testimony from other scientific and/or technical experts.

Respectfully submitted on behalf of the Jojoba Growers Association.

CAROLE A. WHITTAKER, PH.D.,
President.

HEARING ON PROPOSED REGULATIONS ON FARMING SYNDICATE EXPENDITURES

According to the Internal Revenue Service, the proposed regulations on farm syndicate expenditures are being proposed in order to implement changes in the tax law made by the Tax Reform Act of 1976. In the wording of the proposed regulations regarding Sec. 278, the words "fruit", "orchard" and "grove" are given broad definitions and jojoba seed is included as a specific example of a crop for which preproductive costs must be capitalized by farming syndicates. The definitions given in the proposed regulations would include virtually all agricultural crops. Asparagus and artichoke plantations, which also require several years to reach commercial production, would now come under the purview of Sec. 278.

Mr. Bruce E. Thompson, Jr., Asst. Secretary of the Department of Treasury, has stated that:

"Section 278(b) is consistent with general tax accounting rules requiring the cost of constructing a long-lived asset to be capitalized and cost recovery deductions to be claimed only after the asset begins producing income. Although certain active farmers are allowed current deductions for capital outlays in some circumstances, section 278 is designed to deny the benefit of current deductions to passive investors in tax shelter farming syndicates.

"Because jojobas were not produced in substantial quantities in 1976, the drafters of section 278(b) did not specifically consider whether the provision should apply to syndicates that cultivate jojobas. However, the task of the regulations is to interpret the statute so as to implement consistently its underlying rationale. Our understanding is that jojobas, like apple or other fruit trees, require several years of development before producing a commercial crop, and thereafter live and produce for many years. Thus, the proposed regulations treat the production of jojobas the same for tax purposes."

The issue to be dealt with relative to the proposed wording of Sec. 278, and the specific inclusion of jojoba as an example, is not whether Congress should have or would have included jojoba along with fruit and nut tree crops but rather whether Congress, in effect, did include jojoba.

The resolution of the issue relies on the answer to two questions:

1. Did Congress intend to include all agricultural crops or did they limit the coverage of Sec. 278 to fruit and nut tree crops, as those words are commonly understood?
2. Is jojoba seed a fruit or nut tree crop?

The Jojoba Growers Association believes that the legislative history for the Tax Reform Act of 1976 shows that Congress distinguished fruit and nut tree crops from other agricultural crops and chose by intent to include only the former in Sec. 278.

In his comment letter and public testimony today Mr. Heinhold of Shea & Gould, among others, has shown most clearly that in formulating the Tax Law of 1976 Congress considered all kinds of agricultural crops: fruits, nuts, vegetables and nursery stock; tree crops and field crops. However, they included only fruit and nut tree crops in Sec. 278 and relegated vegetable and field crops and nursery stock to inclusion in the at-risk provisions of Sec. 465.

The questions of the classification of jojoba as a fruit or nut tree crop will be dealt with extensively by Prof. Jules Janick, a professor of horticulture for 30 years and the editor for the past 15 years of four journals of the American Society of Horticulturists.

In the next few minutes I would like to give the members of the panel a brief summary of the development of jojoba as an agricultural crop and conclude with a videotape to give you a visual image of the jojoba plant and its flowers, fruit and seed.

In 1975 and 1977 the National Academy of Sciences published studies dealing with the feasibility of developing jojoba as a new agricultural crop. They estimated that 150,000 acres of jojoba plantations would be required to meet the potential demands of the lubricant, pharmaceutical, and cosmetic industries, among others. The Academy recognized that the commercial production of jojoba would require the domestication of a native plant indigenous to the Sonoran Desert. As of 1977, there were no commercial plantations established in the U.S.

Dr. Noel Vietmeyer of the Board on Science and Technology for International Development of the National Academy of Sciences is chairman of a committee charged with making a current technology assessment of jojoba. The committee's findings will be published in July of this year. However, Dr. Vietmeyer has just informed me that his committee has concluded that the process of domesticating jojoba is progressing remarkably well and that the emergence of jojoba as a technically sound agricultural industry is imminent.

During the period 1978 to 1983, some 38,000 acres of jojoba plantations have been established in the southwestern U.S. The first plantations established are now beginning to come into production. For the first time, in 1984, we will obtain jojoba liquid wax from seed harvested from plantations rather than from native stands.

In this short period of time, jojoba growers have made remarkable progress in learning how to grow jojoba under cultivation. Growers have learned to select their growing sites carefully where temperatures do not go below 26° F, where soils are sandy or sandy loam, and where irrigation water is available. We have learned how to propagate jojoba successfully by planting seed directly in the soil and, more recently, by rooted cuttings. We have learned that jojoba requries careful cultivation to remove and prevent weed growth and that it responds well to irrigation and fertilization. Specialized equipment has been adapted or designed for cultivating, pruning and harvesting.

Eventually, growers will achieve higher levels of productivity and greater cost efficiency as we refine cultural practices, learn more about the pollination requirements for jojoba, and begin to make genetic selections for identifying superior plants.

The financing for this mammoth effort has come primarily from private investment capital—perhaps one-third of which is in the form of farming syndicates. These funds have been invested at high risk in developing a new agricultural crop and with the hope and intent of earning a signficant return. Tax deferral or the reduction in investment cost of 30 to 50% from tax savings are not adequate incentives in and of themselves to warrant such investment. These funds have not disappeared down some remote desert wash but have resulted in developing a jojoba industry to the level where it can provide a valuable renewable resource which help to conserve the world's non-renewable resources.

It has been the widespread opinion of jojoba growers, investors and their tax counsels that expenditures for growing costs during the preproductive period could be appropriately taken as current expense since jojoba seed is not a fruit or nut crop. The Jojoba Growers Association concurs with other opinion expressed here and in the numerous comment letters received by the Service that the definitions of fruit, nut, orchard and grove as given in the proposed regulations are too broad and contradict the expressed intent of Congress. We, likewise, recommend that the definition of fruit and nut be deleted from the proposed regulations with an administrative direction that those terms are to have their common and ordinary meaning.

Furthermore, should the Service not see fit to act on this recommendation promptly, the Jojoba Growers Association requests that the Service hold a field hearing so that we can demonstrate the soundness of the emerging jojoba industry.

A 2½-minute videotape showing the following:

1. Native jojoba plants: A young seedling emerging and a mature plant.
2. Jojoba plantations: A field at 1-2 years and then at 5 years showing hedgerows of jojoba under furrow irrigation.
3. 1983 harvest showing a new harvesting machine being used on jojoba.
4. Male flowers losing their pollen to the wind. Female plants with flowers and developing seed on the same branch.
5. Green seed, drying seed and mature seed shown on the plant and fallen to the ground.
6. Seed being extracted for oil.
7. Example of a plant which might be used for selecting superior cultivars.

We thank you for your attention and consideration.

Chairman Stark. Mr. Shooter.

STATEMENT OF A. KELLEY SHOOTER, PRESIDENT, AGRICULTURAL INVESTMENTS, INC.

Mr. SHOOTER. I would just like to take it one step further from where Carole left it in respect to the development of the industry. I think there is a myth in the fact that jojoba is nothing but a tax shelter with a couple beans in the ground and the money is basically lost down the desert wash.

The industry, itself, really started in 1975 and 1977 when the National Academy of Sciences published studies dealing with the feasibility of developing jojoba as a new agricultural crop. They estimated that 150,000 acres would be needed for the potential demands of the lubricant, pharmaceutical, and cosmetic industries. As of 1977, there were no commercial jojoba crops in the United States, and the Academy realized that it would require the domestication of a wild shrub.

Dr. Noel Vietmeyer of the National Academy of Science has recently concluded his assessment of the jojoba industry. Dr. Vietmeyer believes that the progress of the industry to this point is remarkable and that emergence of this as a sound economical agricultural industry is imminent.

I would like to also establish that since 1977, some 36,000 plus acres have been established in the United States. This year, for the first time, commercial production will begin, the oil will be extracted from the bean from plantations rather than from wild stands of jojoba.

We have learned a tremendous amount in the short time we have had jojoba under commercial cultivation. We have learned to be very careful in our site selections, temperatures cannot go below 26 degrees, soils have to be light, well-drained, and there has to be available irrigation.

Also, I would like to dispel the myth that it takes 3 years to determine the sex of a jojoba plant. We have also been able to accomplish, and right now we are planting plants with known sex in the field. We are cloning by rooting cuttings from parent plant material in which the sex has already been identified.

Very much yet remains to be done with the cultivation of jojoba, the refinement of cultural practices and genetic selections. All of this has been, as Carole pointed out, a tremendous mammouth effort funded by private investment and the tax deductions in and of themselves during of the preproductive period are hardly enough to warrant risks that are involved.

I would just like to say that we have at this point in time, put those dollars to use to create a renewable resource to give our country an advantage over our foreign competitors. In conclusion, I would just like to point out that if H.R. 5199 is passed, it will have the exact opposite effect of what it is setting out to accomplish. It will, in effect, reduce taxable revenues rather than increase them.

If we make certain basic assumptions that we have yields beginning with 400 pounds to the acre and going up to 5,000 pounds to the acre, in the 15th year, and that we have a large historical price of $2.50 a pound and growing costs of roughly $1,400 an acre per year, and we take the basic acreage we have, 36,000 acres, and we say that roughly two-thirds of this industry is affected by H.R.

5199, we come to the conclusion that this year if we leave the existing tax laws in place, we will have revenues of taxable income of about $2 million. By 1999, we will have taxable income of over $1 billion per year, totaling $5 billion during that period of time.

If H.R. 5199 is passed, this year, the U.S. Treasury will get back $144 million in tax revenues, but by 1999, Treasury will only be receiving $84 million per year for a total of approximately $666 million.

The point I am making is that at this point in time, Treasury will get back, if we compare the two and we say that they leave the existing tax laws in place versus passing H.R. 5199, that this year Treasury will get back $142 million in taxable income. But by 1999, Treasury will have lost back all of that taxable income and by 1999, Treasury will be losing at a rate of almost $1 billion a year or a net taxable income loss of over $4 billion.

The point I am trying to make is that this is penny wise and pound foolish, and let's not kill the goose that lays the taxable egg.

Chairman STARK. OK.

[The prepared statement follows:]

STATEMENT OF A. KELLEY SHOOTER, PRESIDENT, AGRICULTURAL INVESTMENTS, INC.

DEVELOPMENT OF THE JOJOBA INDUSTRY

In 1975 and 1977 the National Academy of Sciences published studies dealing with the feasibility of developing jojoba as a new agricultural crop. They estimated that 150,000 acres of jojoba plantations would be required to meet the potential demands of the lubricant, pharmaceutical, and cosmetic industries, among others. The Academy recognized that the commercial production of jojoba would require the domestication of a native plant indigenous to the Sonoran Desert. As of 1977, there were no commercial plantations established in the U.S.

Dr. Noel Vietmeyer of the Board of Science and Technology for International Development of the National Academy of Sciences is chairman of a committee charged with making a current technology assessment of jojoba. Dr. Vietmeyer has just informed The Jojoba Growers Association that his committee has concluded that the process of domesticating jojoba is progressing remarkably well and that the emergence of jojoba as a technically sound agricultural industry is imminent.

During the period 1978 to 1983, some 36,000 plus acres of jojoba plantations have been established in the southwestern U.S. The first plantations established are now beginning to come into production. For the first time, in 1984, we will obtain jojoba liquid wax from seed harvested from plantations rather than from native stands.

In this short period of time, jojoba growers have made remarkable progress in learning how to grow jojoba under cultivation. Growers have learned to select their growing sites carefully where temperatures do not go below 26°F, where soils are sandy or sandy loam, and where irrigation water is available. We have learned how to propagate jojoba successfully by planting seed directly in the soil, and more recently, by presexed rooted cuttings. We have learned that jojoba requires careful cultivation to remove and prevent weed growth and that it responds well to irrigation and fertilization. Specialized equipment has been adapted or designed for cultivating, pruning and harvesting.

Eventually, growers will achieve higher levels of productivity and greater cost efficiency as we refine cultural practices, learn more about the pollination requirements for jojoba, and begin to make genetic selections for identifying superior plants.

The financing for this mammoth effort has come primarily from private investment capital—unlike the development of every other crop which has been subsidized by the public sector. These funds have been invested at high risk in developing a new agricultural crop and with the hope and intent of earning a significant return. Tax deferral or the reduction in investment cost of 30 to 50% from tax savings are not adequate incentives in and of themselves to warrant such investment. These funds have not disappeared down some remote desert wash but have resulted in developing a jojoba industry to the level where it can provide a valuable renewable resource which can help to conserve the world's non-renewable resources.

It has been the widespread opinion of jojoba growers, investors and their tax counsels that expenditures for growing costs during the preproductive period could be appropriately taken as current expense since jojoba seed is not a fruit or nut crop, as determined by the head of the fruit crop laboratory at the U.S.D.A..

In conclusion, the following table: Taxable Income Comparison, demonstrates that passage of H.R. 5199 would result in the opposite effect intended by Congress, reduced taxable income. Column A depicts the taxable income from the jojoba industry if the existing tax laws were left in place and the development of the industry continued at its present pace. By comparison, Column B, shows the taxable income from the jojoba industry assuming H.R. 5199 were passed, thereby stifling any further private investment capital. Column C compares the taxable income from passage of H.R. 5199 by deducting Column B from Column A. Thus, passage of H.R. 5199 would result in additional taxable income this year of $141,727,819. However, by 1989 the taxable income gained this year would be lost if the existing tax laws were simply left in place. Moreover, the taxable income lost, as a result of passing H.R. 5199, would total $4,373,298,990 by 1999.

TAXABLE INCOME COMPARISON

Year	Taxable income resulting from existing tax laws	Taxable income resulting from passage of H.R. 5199	Lost taxable income by passage of H.R. 5199
	A	B	C
1984	2,272,181	144,000,000	(141,727,819)
1985	8,912,055		(8,912,055,)
1986	21,246,339	2,138,500	(19,107,839)
1987	40,129,078	5,349,700	(34,779,378)
1988	65,881,637	9,071,800	(56,809,837)
1989	97,553,025	13,331,900	(84,221,125)
1990	135,679,678	18,097,900	(117,581,778)
1991	181,875,906	23,514,950	(158,360,956)
1992	236,665,796	29,497,450	(207,168,346)
1993	301,326,565	36,075,050	(265,251,515)
1994	376,979,349	42,124,725	(334,854,624)
1995	463,968,391	50,706,750	(413,261,641)
1996	564,013,596	58,578,125	(505,435,471)
1997	691,498,165	66,842,750	(624,655,415)
1998	838,099,744	75,519,650	(762,580,094)
1999	1,006,680,310	84,633,575	(922,046,735)
Total	5,032,781,815	659,482,825	(4,373,298,990)

1. Yields:

ASSUMPTIONS

	Jojoba Growers Association	Average	University of Arizona
	(LO)	(M)	(HI)
Year:			
4	200	400	600
5	600	1,200	1,800
6	1,200	1,800	2,400
7	1,800	2,500	3,200
8	2,400	3,200	4,000
9	2,600	3,500	4,400
10	2,800	3,800	4,800
11	3,000	4,050	5,100
12	3.200	4,400	5,600
13	3,400	4,650	5,900
14	3,600	4,900	6,200

ASSUMPTIONS—Continued

	Jojoba Growers Association (LO)	Average (M)	University of Arizona (HI)
15	3,800	5,100	6,400

2. Prices: Since 1977 seed prices have ranged from a low of $1.50 per pound to a high of $10.00 per pound. Generally, prices have ranged between $2.00 to $3.00 per pound. Thus, the average price have been approximately $2.50 per pound.

3. Expenses: The Jojoba Growers Association estimates that the preproduction expenses are approximately $6,000 per acre, averaged over four years. Deductible expenses range from a high of 100% to a low of 60% averaging approximately 75% or $4,600 per acre ($1,125 average per acre per year). Production expenses, including harvesting and marketing, are approximately an additional $275 per acre per year or a total of approximately $1,400 per acre per year.

4. Existing Acreage: According to the 1983 acreage survey, by the Jojoba Growers Association, there are 36,607 acres of jojoba planted in the United States. Less than 1,000 acres were planted prior to 1978. From its inception, the industry has averaged more than a 15% increase in acreage per year.

5. Acreage affected by passage of H.R. 5199: The Jojoba Growers Association estimates that 67% of the existing acreage will be affected by the passage of H.R. 5199.

Chairman STARK. Mr. Knowles.

Mr. KNOWLES. Thank you, Mr. Chairman.

Chairman STARK. We have your testimony, and we will make it a part of the record, without objection. Would you like to proceed to summarize or expand upon it in any way you desire.

STATEMENT OF LAWRENCE R. KNOWLES, SENIOR VICE PRESIDENT, SOUTHWEST JOJOBA CO., PACIFIC AGRICULTURAL SERVICES, INC.

Mr. KNOWLES. Thank you, Mr. Chairman.

The newly formed jojoba industry needs additional investment and debt capital. Nonabusive tax incentives are needed to attract this capital. Jojoba is a new crop and its commercialization has more uncertainty than established crops. Obtaining debt financing at the present time from any conventional lenders is virtually nonexistent. This places a greater demand on investment capital and, therefore, increases the need for tax incentives.

Sometime in the future, the tax incentives could be reduced when the crop is truly commercialized, which may be 50 to 60,000 acres or maybe 150,000, as suggested by the National Academy of Sciences. At such time as it is commercialized, the uncertainty will be diminished and conventional financing from traditional sources should be available, as with other agricultural crops.

The jojoba industry does not need nor does it welcome abusive tax shelters. There have been some abusive tax oriented syndications that have offered investments in jojoba. Based on their investment structure, where the assets are overvalued, questionable promissory notes are signed, resulting in 300 to 400 percent write-off, it is quite clear that their major motive was tax savings and not economic gain.

I would estimate that less than 10 percent of all the acreage planted to jojoba used this type of structure. In fact, maybe the percent is as low as 5 percent.

I do believe that these abusive shelters should be stopped with existing IRS code sections which are designed to prevent them. I am not aware now of any abusive shelters being offered in the jojoba, and I think they were stopped by the existing code sections. I have submitted exhibit A which discussed nonabusive tax incentives and our viewpoint that the Congress did not intend to take away such tax incentives.

The jojoba industry has made a valuable contribution to agriculture and the economy, especially in the States of Arizona and California. We are building an agricultural base of some 40,000 acres, which represents a capital commitment of at least $350 million. Importantly, this growth has not caused any economic displacement of other crops or existing farmers.

In fact, because of the more limited water requirements of jojoba, at least half of this acreage is land that was left to lay fallow in these two States because the crops that were previously grown required three to four times the amount of water.

With this growth, we have now in this country, the largest critical mass of planted acres and, therefore, so should dominate the world market as a supplier for jojoba oil. Other countries are moving forward to try to develop a jojoba industry, but we should be able to maintain our leadership if we don't lose our momentum. This should be done in a way to allow the opportunity to become a major exporter of jojoba oil. This will require intensive cooperation of growers, processors, industrial users, universities, private research labs, Government agencies, and the U.S. Congress.

To give you some idea of the level of commitment in the United States and other international countries in terms of the academic and scientific community, I point to an exhibit B, which I have enclosed this schedule for the International Jojoba Conference which is the sixth semiannual conference to be held at Ben-Gurion University in Beer-Sheva, October 21 to 25. At this conference, over 50 papers will be presented, by representatives of 16 countries, the United States and Israel making up the bulk of the papers being presented.

Congress has shown, I think, their intention to help build this industry with the passage of the Critical Agricultural Materials Act. Public Law 98-284 was signed into law in May, and will provide funding for research and development of critical hydrocarbon containing plants, including jojoba. This plant can provide a renewable source of botan chemicals to replace some of the imported petroleum used for feedstocks in the chemical industry.

It also has widespread usage in industrial products, especially lubricants. A critical agriculture materials task force group has been assembled. We are working with this critical material group, to form a research advisory group to establish priorities for development of these materials and especially lubricants.

The USDA through this law does have a master memorandum of understanding with the Department of Defense to work on joint projects with research which will be of mutual concern which would benefit the United States, including industrial material lubricants.

It was the opinion of the USDA in a letter they submitted to the IRS on March 7, a copy of which is attached as exhibit C, that the proposed relation which was the Service's proposed regulations LR 144-76 for the 1976 act, would impede the development and potential commercialization of a number of crops that have strategic and industrial applications. Mentioned in one of these major crops was the jojoba.

If passed as written, H.R. 5199 would have the same detrimental effect as the proposed regulations, L.R. 144-76. Whereas H.R. 5262, which has been referred to the Ways and Means Committee and was introduced around the same time as H.R. 5199, would not have a detrimental effect.

The jojoba industry has made some major progress in developing industrial lubricant products. Tests have been conducted with these lubricants, both in the labs, and have passed the requirements of some of the major automobile manufacturers and truck manufacturers.

For example, the C-3 test of GM, which means that if the owner of the vehicle purchased from GM use a jojoba lubricant in their vehicle, they will not invalidate the warranty. Wynn Oil Co. a major speciality lube product company, will announce in November that it has added the jojoba product to its lubrication line.

It is important for this industry at this time to have a predictable supply of jojoba oil at a reasonable price to achieve the growth we need in terms of market development. Until the jojoba industry can show that it can be a dependable supplier at a more predictable price, the majors will be reluctant to move forward into research and development efforts which are needed to move a product to market. This is because it takes about 1 to 4 years to bring a product to market. So it is extremely critical at this time that we don't have any interruptions of the momentum on the industry.

It is our feeling that if H.R. 5199 is passed, it could lead to a lack of investment and debt capital. This could mean the funds needed to follow through with the processing and formulation of product development would be lacking and the industry could lose its credibility as a dependable supplier with the major users.

Thank you very much for providing this time for us to testify

[The prepared statement follows:]

STATEMENT OF LAWRENCE R. KNOWLES, SENIOR VICE PRESIDENT, SOUTHWEST JOJOBA CO., PACIFIC AGRICULTURAL SERVICES, INC.

INTRODUCTION

A. Pacific Agricultural Services, Inc. and affiliates:

1. Farm specialty crops such as pistachios, kiwi, grapes and jojoba in Arizona and California.
2. Have been in business for approximately twenty years.
3. Specialize in developing new commercial crops; crops which no not displace established crops or existing farmers.
4. Our growers have direct ownership of land in their own names; not units in a partnership or corporation.
5. Our growers are motivated by economic substance and profit potential of the crops.
6. There is no safeguarding of our growers risk of loss thru structures such as a limited partnership or stop loss agreements.
7. Tax deductions are not highly leveraged; they are the same as any farmer would get; 1:1 for cash invested.

II. JOJOBA INDUSTRY NEEDS INVESTMENT AND DEBT CAPITAL

A. Non-abusive tax incentives are needed for the jojoba industry at this time to attract investment capital. (See exhibit A for detailed discussion.)

1. Commercialization of the jojoba is new and as such has a higher degree of uncertainty than other established crops.

2. Obtaining debt financing from farm cerdit lender or conventional source is virtually non-existent at this time.

B. Need for tax incentives can be reduced sometime in the future when commercialization has been completed.

1. When producing acreage reaches 60,000 to 70,000 acres.

2. Conventional financing will then be available as with other agricultural crops.

III. JOJOBA INDUSTRY DOES NOT NEED OR WELCOME ABUSIVE TAX SHELTERS

A. There have been some highly leveraged syndications offering tax deductions in excess of 200% of capital invested.

1. The major motive is tax savings—not economic and profit opportunity.

2. Tax deductions have been achieved by overvaluing the assets, use of questionable promissory notes.

3. Jojoba investments structured in this manner probably represent less than 10% of the total acreage planted.

4. These abusive tax shelters should be stopped with existing IRC sections which have been designed to prevent such non-economical investments.

IV. THE JOJOBA INDUSTRY HAS MADE A VALUABLE CONTRIBUTION TO AGRICULTURE AND THE ECONOMY

A. growth of agricultural base.

1. In 10 years commercial plantings have grown from several test blocks at the university to 40,000 acres.

2. This represents an investment or capital commitment in excess of $350 million.

3. The growth has not displaced established crops or existing farmers.

4. The more limited water requirements of jojoba farming has allowed reclamation of land which was laying fallow because other crops which were previously farmed required more water than was available.

B. U.S. has leadership role.

1. U.S. has more acres planted than any other country in the world—this provides a "critical mass" needed to dominate the world market.

2. Other countries are moving forward to develop an industry which will produce or use jojoba oil.

3. We should maintain our leadership thru continued investment and become a major exporter of jojoba oil.

4. This will require intensive cooperation of growers, processors, industrial users, universities, private research labs, governmental agencies and the U.S. Congress.

5. The level of U.S. and international commitment to the jojoba industry can be observed by reviewing the schedule for the sixth annual international conference on jojoba and its uses, to be held at Ben-Gurion University, Beer-Sheva, Israel on October 21-25, 1984. (See exhibit B.)

V. CONGRESS HAS SHOWN ITS INTENTION TO BUILD THE JOJOBA INDUSTRY

A. Critical agricultural material act.

1. In May the President signed into law Public Law 98-284, an act to provide funding for research and development of critical hydrocarbon-containing plants including jojoba.

a. These plants can provide a renewable source of Botanochemicals to replace imported petroleum used for feedstock in the chemical industry.

2. The Department has formed a critical materials task force to evaluate the potential and priority of utilizing the funds resulting from this act.

3. Members of the jojoba industry in conjunction with the University of Arizona are in the process of forming a research advisory group to establish priorities for the development of industrial materials—such as lubricants.

4. The USDA has in effect a master memorandum of understanding with the Department of Defense. Under this agreement research of mutual interest and concern will be undertaken which results should be of benefit to the U.S.

5. It was the opinion of the USDA in a letter submitted to the Internal Revenue Service on March 7, (copy attached as exhibit C) that the IRS proposed regulation LR 144-76 would "impede the development and potential commercialization of a

number of crops that has strategic and industrial applications". Mentioned as one of the major crops was jojoba.

6. If passed as written H.R. 5199 would have the same effect as the proposed regulation LR 144-76.

VI. JOJOBA INDUSTRY PROGRESS DEVELOPING INDUSTRIAL PRODUCTS

A. Progress has been made developing industrial lubricants.

1. Several lubrication formulations developed in the industry have been tested by independent labs and field tested with impressive results.

2. These lubricants have passed the necessary requirements of some of the major manufacturers—this allows the owner/user of the equipment to use the jojoba lubricant without invalidating the warranty.

3. One of the major specialty lubrication companies, Wynn Oil, will make a public announcement in November that it has added jojoba lubricants to its product line.

B. A dependable supply of jojoba oil at a reasonably stable price is essential for the growth of the industry.

1. Most industrial products companies who add jojoba to their product line will not do so unless the supply and price is more determinable.

2. The lead time to move a product from R&D to marketing full distribution takes from one to four years.

3. Product development and marketing will not move forward until the jojoba industry can show continued progress in supply.

SUMMARY

We are concerned that if H.R. 5199 is passed by the Congress, the effects would be detrimental to the growth of the jojoba industry at this time. Specifically:

A. Investment and debt capital would be discouraged, leading to,

B. Lack of funds to follow thru with processing, formulation and product development,

C. The industry would loose its creditability as a dependable supplier with major users.

EXHIBIT "A"

SHEA & GOULD,
Washington, DC, January 13, 1984.

Mr. ROSCOE L. EGGER, Jr.,
Commissioner, Internal Revenue Service,
Washington, DC.

DEAR SIRS: We have reviewed the Notice of Proposed Rulemaking dealing with farm syndicate expenditures. We believe we understand the motivation of the Service in attempting to restrict investments in agricultural operations that have been perceived to be abusive tax shelters. We agree that there are sales of participations in farming activities that are motivated primarily by tax considerations and are, in fact, abusing the favorable tax treatment designed to aid farmers and others who invest in farming operations and remain "at risk."

However, we believe the proposed regulations under Section 278 and Section 464 of the Internal Revenue Code of 1954, in order to accomplish the purpose of curtailing abusive tax shelters, have not followed the legislative intent in some respects and, through a lack of specificity, directly contradicted the legislative intent in other respects. The proposed regulations have defined certain farm produce so broadly as to encompass virtually all farm produce including a number of products that were specifically intended to be excluded from the administration of Section 464.

The point we wish to make most strongly is that we agree that abusive tax shelters must be curtailed but these proposed rules are excessively restrictive; impacting not only abusive tax shelters, but also on the individual investor who is fully at risk and is motivated by the profit potential in the investment.

I. SUMMARY

Following a through review of Congressional and administrative attempts to deal with agricultural investments that have been perceived to be abusive tax shelters we respectfully submit the following conclusions.

There is abuse by a number of syndicated limited partnerships selling highly leveraged interests in farm operations that are not primarily motivated by profit but rather are highly leveraged, limited risk investments primarily motivated to shelter non-farm income from tax. The history of Congressional involvement and concern with tax shelter investments in farming operations indicates very clearly that Congress was primarily concerned with economic displacement of certain crops and the curtailing of business combines that offered highly leveraged and low risk investments.

Congress recognized that special farm tax rules confer tax benefits on those engaged in farming activities and, simultaneous with the enactment of restrictions on farming syndicates, specifically endorsed the continuation of those tax benefits to individuals who, motivated by profit and fully at risk, invest in farming operations. The definition of "farm syndicate" was never intended to include the individual farmer who was primarily motivated by a desire to make a profit in the investment.

In 1976 Congress restricted agricultural investment programs made by "farm syndicates" but made a clear distinction between investments in "tree" crops and "field" crops. Only investments by farm syndicates in tree crops would be restricted under Section 464 and Section 278 of the Code while investments by syndicates and non-syndicates in field crops would be restricted under Section 465 of the Code.

The term "active management" as it relates to farms and farming operations is present in Sections 464 and 2032A of the Internal Revenue Code. Absent an expressed Congressional intent to do otherwise, regulations under those Code sections should have a uniform interpretation of the term "active management." The proposed regulations under Section 464 impose a standard that is substantially more demanding than the standard imposed by the same term "active management" in Section 2032A.

The definition of "fruit" and "nut" in the proposed regulations under Section 464 is too broad. As a result, it includes not only produce that is not commonly understood to be fruits or nuts, but also includes virtually all plants and produce encompassing even those specifically intended to be excluded by Section 464 and to be governed by Section 465.

II. BACKGROUND AND LEGISLATIVE HISTORY

1. Congressional review of farm investments

Taxpayers engaged in farming may report their income and expenses from farm operations on the cash method of accounting, without accumulating inventory costs. In addition, the Treasury has long permitted farmers to deduct currrently many of the costs of raising or growing farm assets which are held for the production of income. These favorable tax rules offer investors in farming operations an opportunity to defer taxes on nonfarm income. This result, as may be seen from the legislative history, was specifically intended. It was also understood that favorable tax treatment offered to farm investments would have an additional beneficial effect in that it would attract needed capital to the farming industry. However it was not understood nor intended that the favorable tax rules would attract capital in such large quantities to a few long established farming operations that it would cause havoc in the marketplace for certain farm products.

In 1969 Congress reviewed the tax shelter programs then in use. After reviewing the law and the programs attracting capital in exchange for tax deferral, Congress acted to restrict certain tax shelter programs, but only in *one* crop, namely, citrus. The reason for the limited restrictions was quite simple. So many orange and grapefruit groves were begun as a result of tax shelter programs that once the groves started to produce they caused an oversupply in the market place; depressing the market price and threatening the citrus farmer with economic displacement.

In 1971 the same pattern was followed. Although there were tax shelter programs available for investment in many agricultural products, Congress acted to restrict only those causing or threatening economic displacement of traditional farmers with a particular crop. Thus in 1971, almond trees were added to citrus groves under Section 278. It is important to note here that these farm products were singled out for special treatment, *not* because there was anything inherently onerous about citrus or almond trees, but because Congress was concerned about economic displacement of those farmers.

In 1976 the scope of Congressional review of farming syndicates was much broader. The focus, however, continued to be whether such investments had caused economic displacement of traditional farm operations. There was testimony on the popularity of the tax shelter investment in shell eggs that revealed greater writeoffs per investment dollar than cattle feeding and breeding tax shelters. Farmers again complained that outside investors seeking tax shelters distorted the economics of the egg industry and produced instability in egg prices [Tax Reform Hearings, 94th

Cong., 1st Session, 213 (July 15, 1975), Statement of John Wallace, President, United Egg Producers].

Aside from the economic displacement argument to curtail shelters, Congress received a good deal of testimony on another unforeseen and unintended aspect of the farm investment programs namely, the limited liability of the investor. Through the use of limited partnerships, stoploss orders, guaranteed purchase and repurchase agreements, insurance and nonrecourse bank borrowing, and investor could not only shelter non-farm income but could do it at 4 or 5 times his actual investment and virtually without risk.

This background is important in order to unserstand exactly what Congress was attempting to do in 1976 when it added Section 464 and Section 465 to the Code. Congress clearly intended to continue the favorable tax treatment for farm investments. Congress also recognized and specifically condoned the use of farm investments to shelter non-farm income but refused (by rejecting the House approach) to put a ceiling on the level of non-farm income that could be sheltered. It is also clear that Congress continued to be concerned with the economic displacement of certain crops.

"Grape harvests are currently at record high levels, particularly in the case of wine grapes. The result is expected to be a period of price reductions for various domestic wines until demand catches up with the current oversupply . . . .Some part of the current harvest can probably be traced to plantings by tax shelter syndicates during the early 1970's." (Tax Shelter Investments, Joint Committee on Internal Revenue Taxation pamphlet, prepared for use by the Senate Finance Committee, April 14, 1976, Footnote p. 54)

This concern led directly to "vineyards" being added to section 278. But aside from the demonstrable concerns and intentions, it is clear that Congress intended to restrict the growth of the farm investment combines that inflated the deductions and yet limited the risk of the investors. However, it was never the intention of Congress to restrict those investors who owned or leased the land in their own name; who risked their entire investment and received only those tax deductions proportionate to his cost and total investment.

2. Definition of farm syndicate

Both the House and Senate clearly recognized the tax benefits that were available to investors in farming operations and both Houses specifically stated their desire to continue those tax benefits.

"Tax motivations currently play an excessive role in many investment decisions in farm operations. In some situations tax incentives for active farmers are desirable. However, in many other situations such as those involving the packaging of tax incentives in syndicated farming operations, tax incentives under present law do not benefit those for whom they were principally intended. Since such syndicates are motivated primarily by tax consequences rather than by a desire to conduct farming activities in the most economically profitable ways, your committee feels that it is appropriate to continue to extend to them all of the farm tax incentives of present law. Your committee belives that reducing tax incentives for high-bracket taxpayers with nonfarm income will improve the competitive position of full-time farmers who must look to the income generated from farm operations for all or most of the return on their investment in farm operations." (House Report No. 94-658, p. 44)

However, it is also clear that the Congress did not want to extend the tax benefits to purely passive investors whose primary motivation was the generation of tax losses rather than being motivated by a desire to make a profit in the particular farming operation. [Senate Report No. 94-938, p. 58].

The obvious difficulty in drafting the 1976 legislation was to structure a rule that would allow the individual who was seriously interested in the economic return of his farm investment to continue to receive tax benefits (even the sheltering of non-farm income was specifically endorsed in the House Report) and disallow those benefits to the purely passive tax shelter.

After reviewing a host of tax shelter programs designed to invest in farm operations it was clear that the majority of shelter programs involved farm "syndicates" using the organizational form of a limited partnership. Webster's definition of a syndicate is "an association or group of persons or concerns who combine to carry out a particular transaction." In this association Congress saw the distinction it wanted to make. The individual farmer wasn't in a syndicate and he generally could not exaggerate his investment thorough non-recourse loans nor through stop-loss orders nor guaranteed prices. Thus Congress decided that the farm syndicate would be the type of investment program that would not share in the tax benefits available to the serious individual investor in farming operations.

"Use of farming syndicates.—These special farm tax rules have been utilized not only by taxpayers who were actively engaged in farming enterprises with the intention of making a profit, but also by passive investors whose motivation, in large part, consisted of a desire to use these farming rules to shelter income from other sources. These passive investors were frequently members of "farming syndicates" formed by a promoter or operator. In order to offer attribution of losses and limited liability to the investor, a farming syndicate has generally been structured as either a limited partnership or as an agency relationship with a management contract (and with limited liability generally provided for by nonrecourse indebtedness, insurance, stop-loss guarantees, etc.)" (General Explanation of the Tax Reform Act of 1976, p. 45)

Recognizing that the limited partnership form of organization was not the only form available, the House definition of farm syndicate included an "enterprise" other than a limited partnership. However the Senate specifically expressed its concern that the term "enterprise" could be interpreted to include those legitimate individual investors in farm operations.

"The committee amendment is essentially the same as the approach taken by the House bill with respect to the definition of farming syndicates, except that the House bill included as a third category of farming syndicates, enterprises (other than limited partnerships) . . . . *The committee is concerned that the definition of the third category of farming syndicates is too broad and will have an adverse impact on many legitimate farmers and ranchers.* Accordingly, the committee amendment modifies the House bill to provide that, in defining this third category of farming syndicate, the focus is to be on the fact that a person or persons is involved whose liability is limited to his investment in the farm enterprise rather than the degree of active participation of the person (or persons) in the operation or management of the enterprise." (Senate Report, p. 60) Emphasis added.

In order to insure that the term "enterprise" would not be interpreted so broadly as to adversely affect legitimate farm investments, the Senate suggested that the term would include investors with limited liability. The distinction between investors with limited liability and those who had unlimited liability is valid because every abusive tax shelter offers its investors limited liability. The individual investor, on the other hand, cannot limit his liability and must be motivated more by profit potential than tax benefit potential.

"*Thus, the committee believes that this third category of farming syndicates should be limited to those farm enterprises in which a person (or persons) with limited risk is involved.* Thus the fact that an investor delegates authority to an agent or hires an independent contractor will not in itself render the investor subject to the farming syndicate rules unless there is limited risk." (Senate Report, p. 60) Emphasis added.

The Conference Committee substituted the concept of "limited entrepreneurs" for "limited liability" but the Report makes it clear that limited liability remains a factor in determining the existence of a "limited entrepreneur."

3. Sections 464 and 278 were to apply only to "tree" crops and not "field" crops

In 1975, the Ways and Means Committee began another investigation into the abuses of tax shelter investments in agricultural operations. After a month of public hearings and debate the Committee issued a Report and bill which eventually became the Tax Reform Act of 1976. In its Report, the Committee noted that since Congress had restricted the selling of tax shelter programs in citrus groves in 1969 and then almond trees in 1971, there had been a substantial increase in the number and volume of publicly syndicated limited partnerships for investments in "cattle feeding and breeding, tree crops, vegetable and other field crops, chickens and egg production." [House Report No. 94-658, p. 40]

The House Report reviewed and detailed the various categories of popular tax-shelters including:

"*Winter vegetables and other plant shelters.*—Shelters involving the growing of winter vegetables operate in essentially the same method as cattle feeding and egg production shelters. . . . Similar deferral shelters can be found in the raising of horticultural plants where significant expenses are incurred in one year and the related income is realized in the following year. For instance, programs for raising azaleas, rosebushes, and juniper plants have also been used to defer, or "roll over," taxes on nonfarm income from one year to another." (House Report, p. 43)

The Committee made it very clear that the vegetable and plant shelters were categorically different from the tree crop shelters. The Report continued with a description of this category:

"*Orchards, groves and vineyards.*—An investment in an orchard, vineyard or grove involves a "tree crop" as distinct from a "field" crop such as vegetables. The list of tree crop partnerships covers virtually anything grown in an orchard or vineyard in the form of trees or vines which produce annual crops of fruits (e.g., grapes, apples or avocados) or nuts (e.g., pecans, pistachios or walnuts)." [House Report, p.43]

The House bill was sent to the Senate late in 1975 and the Finance Committee held nearly 2 months of hearings during the summer of 1976 before issuing its Report. As it related to tax shelters, the Senate Finance Committee made many changes in the House approach to restricting abusive shelters by syndicated limited partnerships.

In the explanations of the amendments to Section 278 and the addition of Section 464 to the Code, the Senate Report language is nearly identical to that of the House Report. And, although the Senate Report again describes the cattle feeding shelter program and the "Orchards, groves, and vineyards" tax shelter, it does not make reference to the tax shelter programs investing in other plants or field crops, such as vegetables, rosebushes, and other nursery plants.

The Senate Report does however, again make the distinction between tree crops and field crops. This is significant because the Senate and then the Congress in adopting the Senate approach, never intended Sections 278 and 464 to apply to field crops or plants other than fruits and nuts as those terms are commonly understood. Consistent with this approach, nursery plants, vegetables etc., are encompassed under the description of the newly added Section 465, "Limitation Of Loss With Respect To Farms To The Amount For Which The Taxpayer Is At Risk." (Senate Report, p. 62.)

In fact, the very purpose of Section 465, as opposed to Section 464, is to restrict the abusive use of tax shelter farm investments in all crops except the fruit and nut crops which are covered by section 278 and section 464.

The Senate Report explained the purpose of Section 465 in these words:

"Taxpayers have combined the special farm rules with nonrecourse indebtedness and stop-loss orders, etc., to deduct losses in a taxable year which are substantially in excess of the maximum amount they could ultimately lose with respect to their investment in farming. Although some of these situations may be limited by the restrictions on deductions imposed on syndicates . . . some farming shelters may not involve syndicates. Also, the limitations on syndicates do not affect all types of farming operations. *For instance, winter vegetables, rosebushes and other nursery plants are not restricted by the restrictions on farming syndicates, except to the extent that such syndicates, utilize prepaid seed, fertilizer, and other farm supplies.*" (Senate Report, p. 63) Emphasis added.

4. Definition of active management

The term "active management," is contained in Sections 2032A and 464 of the Internal Revenue Code and is used to describe a degree of participation in farm operations. Section 2032A deals with the estate tax treatment of farm operations and Section 464 deals with the income tax treatment of farm operations. In both sections, Congress used the term "active management," to describe a level of qualifying activity and involvement by individuals and, absent any expressed intent to do otherwise, it must be presumed that Congress intended the term to have the same meaning in both sections of the Code. There is no reason for the terms to differ in meaning.

In addition to the term "active management," the Tax Reform Act of 1976 also used the term "material participation" in section 2032A to describe a *higher* degree of involvement in farm operations than "active management."

"Active management means the making of business decisions other than daily operating decisions, and requires a lesser standard of involvement than material participation." (House Committee Reports. § 104(b), Tech. Corrections Act).

In 1976 the term "material participation", however, was already in use in the Code in Section 1402, relating to the Self Employment Tax. Quite properly the regulations under Section 2032A explicitly referred to the definition of the term as it is used in Section 1402 in order to insure a uniform and consistent definition for tax purposes. However, no such effort was made to coordinate the term "active management" under Sections 2032A and 464.

The degree of involvement in farm operations as required by the definition of "active management" in the newly proposed regulations under Section 464 is far greater than that required under Section 2032A. The statute under Section 2032A(e)(12) defines "active management" as the making of the management decisions of a business other than the daily operating decisions. The regulations under

Section 464 require much more. In fact the degree of participation required by the proposed regulations under Section 464 for "active management" exceeds the participation necessary for the higher standard of "material participation" under Section 1402 and Section 2032A. This would lead to the anomalous result of a farmer being deemed to have such a great degree of involvement in a farm as to be subject to the self-employment tax under one regulation and yet be deemed to be a "passive investor" in a farming operation under the newly proposed regulations for Section 464. Certainly Congress could not have intended the same statutory language to have such conflicting results.

5. Definition of fruit and nut

Proposed regulation section 1.278-2 defines "fruit" as "a fertilized and developed ovary of a plant, including the seeds, or, in the case of a plant that does not bear seeds, the fertile structure of the plant." A "nut" is defined as "a hard-shelled fruit." These generic definitions may be botanically correct in the sense that all fruits and nuts are "fertilized and developed ovaries of a plant" but certainly not all fertilized and developed ovaries of a plant are fruits! The definitions are so broad, so all-encompassing, that they apply to not only what is commonly understood to be a fruit or nut, but they also apply to virtually *all* plants. For example. Under this definition, wheat, alfalfa and vegetables are fruits! Does the Service seriously contend that wheat is a fruit? Is wheatgerm a nut?

Does the Service really believe Congress intended to include these crops and hundreds of others as fruits?

The proposed regulations offer examples of common fruits that meet the definition: "Apples, avocadoes, grapes, jojoba beans." The inclusion of the jojoba bean in this list of fruits is simply incorrect. By common standards, the jojoba is neither a fruit nor a nut. The jojoba bean when crushed produces a remarkable oil-like substance that is actually a wax. The "oil" has properties that do not oxidize of change viscosity under high temperatures of high pressure and consequently it is used as an extreme pressure lubricant in machinery. In fact because of its unique lubricating qualities it has been named a critical agricultural commodity in the Arid Lands Renewable Agricultural Resources Corporation Bill (H. R. 4213 and S. 1462) currently pending in Congress. In its Report, the Committee on Science and Technology described jojoba and its uses in this way:

"Jojoba, which grows in the Southwest produces a superior lubricant and feedstock for plastics and fertilizer . . . The oil from the jojoba is the only known replacement for sperm whale oil which is used as a long term lubricant for inaccessable parts, such as moving parts near nuclear reactors." (H Rept. No. 98-109, 12)

There is no suggestion in these bills or Congressional Reports that jojoba is a fruit or nut in the same category as apples and pistachios. Moreover, in 1976 jojoba was not being commercially produced in any quantities and therefore could not have been intended by Congress to be included in the restrictions added to section 278.

III. RECOMMENDATIONS

Definition of fruit and nut

The definition of fruit and nut in the proposed regulations is not sufficiently precise. Clearly it is an attempt to distort the scope of section 278 in order to include an investment program in a specific crop that the Service views as abusive. In that attempt the Service has used language that encompasses not only the perceived offending crop, but a host of other crops, some of which Congress expressly excluded.

It is not our primary purpose to argue the merits of a particular investment program or of a particular crop. Nor is it our purpose to argue against the perceived abuses of a particular farm investment program. Essentially those are questions of fact and no doubt others, more familiar with the facts, will make their presence known.

We submit that the definition of fruit and nut as used in the proposed regulations is too broad and contradicts the expressed intent of the Congress. If Congress had intended to include all crops it could have easily mandated that result. By the very fact that Congress specifically included citrus and then almonds and then made parenthetical references to apples, avocadoes and grapes, it is clear that it did not intend to include all crops. The IRS must give weight to the fact that Congress was fully apprised of tax shelter investment programs in 1976 and that Congress modified section 278, but chose not to expand its scope to all crops. We respectfully submit that the Service may not do administratively what Congress has chosen not to do legislatively. We recommend that the definition of fruit, and nut be deleted from the proposed regulations with an administrative direction that those terms are to have their ordinary and common definition.

If the IRS firmly believes that there is a clear abuse in an investment program in a particular crop, then the IRS has the ability to present those arguments to the Congress and invite the Legislature to change the law. But the Service may not do it by Administrative regulations.

Definition of farm syndicate

We do not disagree with the policy that places restrictions on farm syndicates. Nor do we disagree with the statutory language and Congressional intent in defining farm syndicates. However we do disagree with the focus of the proposed regulations and the weight given to certain factors in determining what is and what is not a farming syndicate.

The proposed regulations have attempted to distinguish abusive tax shelters from legitimate farm investments on the basis of the farm product. Unfortunately the product is subject to several differing definitions. We believe the proposed regulations can achieve the goal of eliminating abusive tax shelters—within the legislative mandate—if a standard is developed that is based on the economic substance of the investment.

As shown in these comments there is ample documentary evidence that Congress intended to curtail tax shelter programs that contained the following elements:

A. Program that are primarily motivated by tax considerations rather than profit potential;

B. Programs that exaggerate tax deductions relative to the cash investment (leverage); and

C. Programs that safeguarded the investor against risk of loss.

If these elements are removed from an investment program then the abuses are also removed and the investment can be evaluated on its economic substance. We recommend the addition of the following clause to the proposed regulations which we believe accomplishes these purposes:

§ 1.464-2 Farming syndicates—definitions and special rules.

(a) Farming Syndicate.—

* * * * *

(5) Active partners and entrepreneurs.

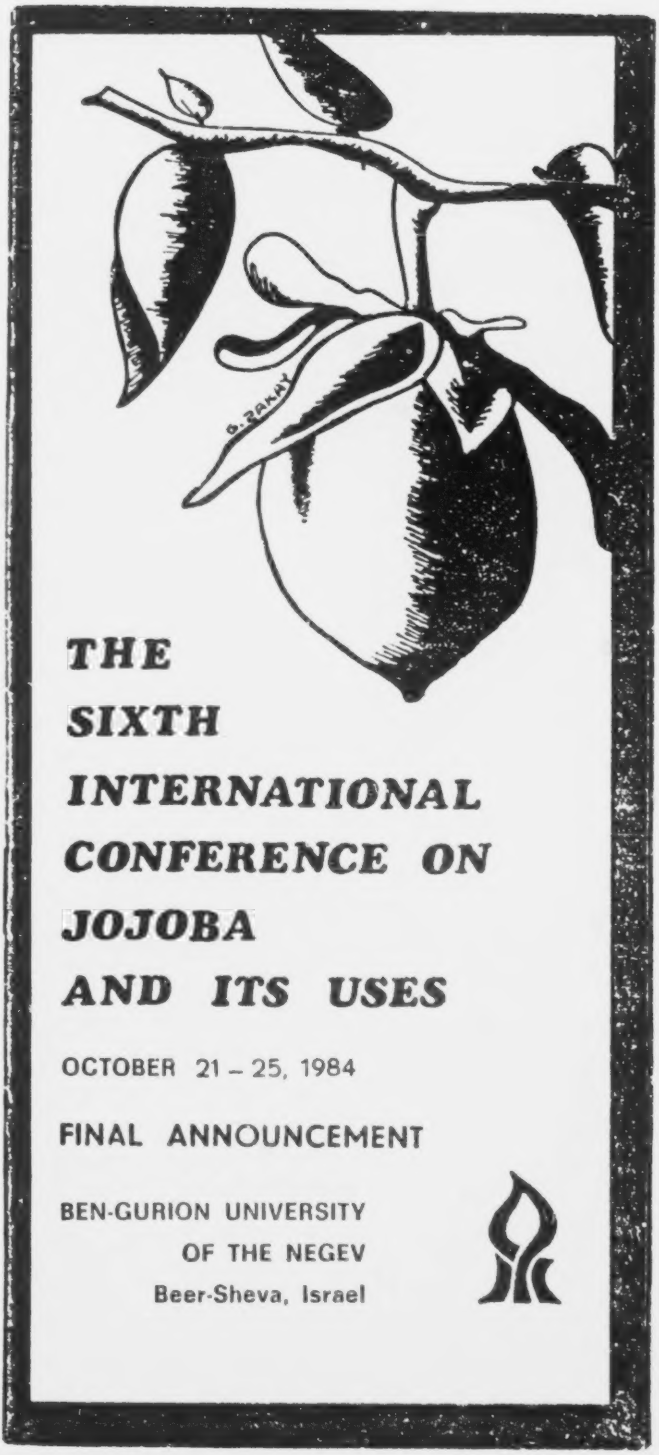
* * * * *

(iv) Any interest in property, provided that the title or lease to the property is held in the name of the taxpayer and provided further that the taxpayer is not protected against losses to any significant degree by nonrecourse financing, stop-loss orders, guarantees, fixed price purchase or repurchase agreements, insurance or other similar arrangements, and; the deduction under this sectioin may not exceed the cash investment of the taxpayer in any one taxable year.

Respectfully submitted.

JAMES C. HEINHOLD.

EXHIBIT "B"



THE SIXTH INTERNATIONAL CONFERENCE ON JOJOBA AND ITS USES

OCTOBER 21 – 25, 1984

FINAL ANNOUNCEMENT

BEN-GURION UNIVERSITY
OF THE NEGEV
Beer-Sheva, Israel

THE SIXTH INTERNATIONAL CONFERENCE ON JOJOBA AND ITS USES

Ben-Gurion University of the Negev
Beer-Sheva, Israel

October 21—25, 1984

FINAL ANNOUNCEMENT

The Conference is co-sponsored by :

- International Jojoba Council
- National Council for Research and Development
- Delek, The Israel Fuel Corporation
- Negev Jojoba Company

Organizing Committee :

- Meir Forti
- Yair Inov
- Izhar Raz
- Alfred Shavit
- Jaime Wisniak

Conference Chairman :

Prof. Jaime Wisniak
Dept. of Chemical Engineering
Ben-Gurion University of the Negev
Beer-Sheva 84105, Israel
Tel. (057)664781
Tlx: 5253 UNASI IL

Conference Arrangements and Tourist Services :

ORTRA LTD.
431 Namir Square
Tel Aviv 61 033, Israel
Tlx: 361142 — Tel.: (03)289128

CHAIRMAN'S MESSAGE

On behalf of the organizing committee of the Sixth International Conference I extend to you a most cordial welcome to Israel and the Ben-Gurion University of the Negev.

This is the first time the Conference will take place outside the American Continent, and participants from all over the world will be attending and creating a stimulating international atmosphere.

We have prepared a technical program that will give the participants a complete picture of the state of the art in jojoba development around the world and in Israel in particular. The four-day program includes lecture sessions on all aspects of jojoba agriculture, physiology, marketing, economics, and uses of the oil and derivatives. A closing panel discussion will summarize the present and try to identify future developments and problems. A full-day trip will take the participants around the Negev desert on a visit to plantation sites, the Tissue Culture facilities, and a demonstration of the mechanical harvester.

We hope you will enjoy your visit to Beer-Sheva and we will spare no effort in trying to make the Sixth Conference and your visit to Israel a most enjoyable experience.

Sincerely,
JAIME WISNIAK, Chairman
Sixth International Conference

PROGRAM

Sunday, October 21, 1984

16.00 Registration at Desert Inn Hotel

20.00 Get-Together, Desert Inn Hotel

Monday, October 22, 1984

08.00 Registration and Refreshments — Kreitman Building, New Campus

10.00 Opening Remarks
— **Gen. (res.) SHLOMO GAZIT,**
President of Ben-Gurion University of the Negev
— **JAIME WISNIAK,** Chairman of the Conference

10.30 Session 1 — **Jojoba Around the World**

13.00 Lunch

14.30 Session 2 — **Propagation by Cuttings and Tissue Culture**

16.30 Coffee Break

17.00 Session 3 — **Agricultural Developments I**

20.00 Reception by Gen. (res.) SHLOMO GAZIT, President of Ben-Gurion University of the Negev

Tuesday, October 23, 1984

08.30 Session 4 — **Agricultural Developments II**

10.00 Coffee Break

10.30 Session 5 — **Jojoba Physiology I**

13.00 Lunch

14.30 Session 6 — **Jojoba Physiology II**

16.30 Coffee Break

17.00 Session 7 — **Marketing and Economics**

20.00 Reception and Folklore Evening Sponsored by the Municipality of Beer-Sheva

Wednesday, October 24, 1984

All day — Field trip: Visit to plantation sites, experimental plots, exhibition of a prototype of the harvesting machine, and the Tissue Culture Plant of Negev Jojoba Co.

Thursday, October 25, 1984

08.30 **Session 8 — Biology, Chemistry and Technology of Jojoba Oil and Meal I**

10.00 Coffee Break

10.30 **Session 9 — Biology, Chemistry and Technology of Jojoba Oil and Meal II**

13.00 Lunch

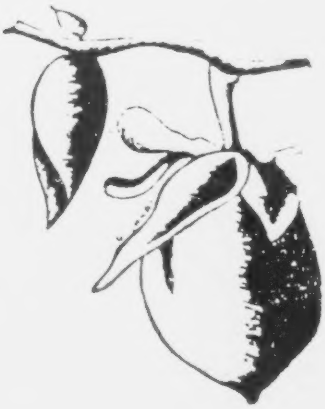
14.30 **Session 10 — Biology, Chemistry and Technology of Jojoba Oil and Meal III**

16.30 Coffee Break

17.00 Panel Discussion — Conference Closure

20.00 Gala Conference Dinner

All sessions will take place in Auditorium 06, Kreitman Building.



GENERAL PROGRAM

Monday, October 22, 1984

SESSION 1 (10.30—13.00 hr.)

JOJOBA AROUND THE WORLD

"Jojoba Cultivation in the Southwestern U.S.: Acreage, Yields and Cultural Practices"

WHITTAKER C.A., THELANDER, R.B. (USA)

"Jojoba in Brazil"

ARAGAO, G.M., DE OLIVEIRA, JONAP (Brazil)

"Production Indices of Jojoba Without Irrigation in Villa Dolores, Cordoba, Argentina"

AYERZA, R. (Argentina)

"Jojoba in Spain"

GARCIA, A. (Spain)

"Jojoba Perspective in Mexico — Twelve Years Later"

MURRIETTA, X. (Mexico)

"Introduction of Jojoba in India"

SINGH, H.G. (India)

"Jojoba: A New Potential Plant for Paraguay"

SPINZI, J.G. (Paraguay)

"Jojoba as a Potential Crop for Chile"

TORREALBA, J.P., ACEVEDO, E. (Chile)

"Jojoba in Western Australia"

HAWSON, M.G. (Australia)

SESSION 2 (14.30—16.30 hr.)

PROPAGATION BY CUTTINGS AND TISSUE CULTURE

"Vegetative Propagation by Tissue Culture"

BIRNBAUM, E (Israel)

"Practical and Scientific Aspects of Vegetative Propagation of Jojoba Cuttings Using Fog"

BROWN, J.H., CAMPBELL, A.M. (USA)

"Plant Tissue Culture and Immunological Studies of Jojoba"

CHEN, P.K., VENKETESWARAN, S., O'BRIEN, W.H. (USA)

"The Selection and Cloning of Superior Jojoba"

KOENIGSBERG, S., LIN, F.F. (USA)

"Seed Yield and Variation of Clonal Jojoba in Mexico"

RAMONET-RAZCON, R. (Mexico)

"Factors Affecting Rooting of Jojoba Cuttings"

ABRAMOVICH, R., FORTI, M., HAUSNER, S. (Israel)

SESSION 3 (17.00—18.30 hr.)

AGRICULTURAL DEVELOPMENTS I

"1984 International Provenance Trial : Report on Methodology and Initiation"
ZEASER, D. (Costa Rica)

"The Utilization of Arid Land Agronomic Practices for Jojoba Plantation Development"
LUDEKE, K.L. (USA)

"A New Planting Concept for Jojoba"
SMITH, N.C. (Costa Rica)

"Management Methods for Increasing Yield Potential of Direct Seeded Jojoba Plantations"
CAMPBELL, A.M., BROWN, J.H. (USA)

"Opportunities for Improvement in Jojoba Production"
LOWENSTEIN, H.M. (Holland)

"The Formation of a National Jojoba Industry in Australia"
LANNY, T.R. (Australia)

Tuesday, October 23, 1984

SESSION 4 (08.30—10.00 hr.)

AGRICULTURAL DEVELOPMENTS II

"A Search for the Origin of Jojoba"
KADISH, A. (USA)

"Jojoba Growing in Australia"
HAMER, R. (Australia)

"The Use of NAA to Control Basal Sprouting on Pruned Jojoba"
SUMMERS, L.L., BOSWELL, S.B., TIMMONS, T.,
WILLIS, K., WHITTAKER, C. (USA)

"Mechanical Harvesting of Jojoba Beans"
SARIG, Y., GROSZ, F., MALKIN, O., RASIS, A.,
BERES, H., TOMASHOFF, R. (Israel)

"Mechanical Harvesting of Jojoba with the Littau Harvester"
MERRILL, R.C., TRYON, J.L. (USA)

"Vegetable Intercrop for Jojoba"
REAMES, A. (USA)

SESSION 5 (10.30—13.00 hr.)

JOJOBA PHYSIOLOGY I

"Antibodies Against Sex Determinants in Jojoba"
CORDOBA, F., MUNOZ, I., ESPINOSA, P. (Mexico)

"Effect of Environmental Factors on Wax Content and Composition"
DUNSTONE, R.L., TONNETT, M.L., MILTHORPE, P.L.
(Australia), BENZIONI, A. (Israel)

"Environmental and Hormonal Effects on Flowering in Jojoba"
BENZIONI, A. (Israel), DUNSTONE, R.L. (Australia)

"The Role of Biological and Edaphic Interactions in Jojoba Production"
FOERSTNER, L.W., BLASS, H.E. (USA)

"Heat Resistance of Jojoba Pollen : Prospects and Advantages of its Storage"
JAUHAR, P.P. (USA)

SESSION 6 (14.30—16.30 hr.)

JOJOBA PHYSIOLOGY II

"Effect of the Genetic Background on Factors Conditioning the Yield"
FORTI, M., NERD, A. (Israel)

"Sensitivity to Water Stress of Vegetative and Reproductive Growth in Jojoba Females"
NERD, A., BENZIONI, A. (Israel)

"Role of Glyoxylate Cycle Enzymes in Germinating Seeds of Jojoba"
SITTON, D., YARON, A., ROTH-BEJERANO, N. (Israel)

"Effect of Different Water Regimes on Xylem Water Potential"
BENZIONI, A., NERD, A. (Israel)

"Organ Specific Composition and Surface Structure of Epicuticular Waxes from Jojoba"
GULZ, P.G. (Germany)

"New Grass Herbicides Show Good Control of Bermuda Grass in Jojoba"
SUMMERS, L.L., TIMMONS, T., WHITTAKER, C. (USA)

SESSION 7 (17.00—18.30 hr.)

MARKETING AND ECONOMICS

"Production, Market and Price Considerations for Jojoba Seed and Oil"
CHUTE, J. (Australia)

"Economics, Markets and Development"
INOV, Y. (Israel)

"Jojoba Market Development in the United States"
KNOWLES, L.R. (USA)

"Jojoba Oil Marketing"
MANOLO, R.A. (USA)

"Evaluation of the Profitability of a Commercial Jojoba Plantation"
LUBBERT, F. (Mexico)

"Economics and Forecasting Criteria in Evaluating Investment in Jojoba Plantations"
RIMON, D. (Israel)

"Innovation Diffusion of Jojoba"
FRANZ, J.C. (Germany)

Thursday, October 25, 1985

SESSION 8 (08.30—10.00 hr.)

BIOLOGY, CHEMISTRY AND TECHNOLOGY OF JOJOBA OIL AND MEAL I

"Chemistry and Technology of Jojoba Oil : State of the Art"
WISNIAK, J. (Israel)

"Jojoba Grower's Association's Jojoba Seed and Oil Standards Committee Progress"
PURCELL, H.C. (USA)

"Developments in the Analysis of Jojoba Wax"
TONNETT, M.L., DUNSTONE, R.L. (Australia)
SHANI, A. (Israel)

"Absorption and Distribution of Jojoba Oil After Oral Administration to Rats"
BIZZI, A., CINI, M., BRACCO, U. (Switzerland)

"Nutritional Investigations on Jojoba Oil"
DECOMBAZ, J., HEISE, C., ANANTHARAMAN, K., (Switzerland)

SESSION 9 (10.30—13.00 hr.)

BIOLOGY, CHEMISTRY AND TECHNOLOGY OF JOJOBA OIL AND MEAL II

"Physiological Effects of Jojoba Oil in Laboratory Animals"
YARON, A., BENZIONI, A., MORE, I., MESHORER, A (Israel)

"Treatment of Acne and Psoriasis"
MOSOVICH, B. (Israel)

Cosmetics Based on Jojoba Oil: Oxidation Stability Study"
LIBBY, H., PURDY, R.H., REALINA, R.L., LUGTO, T.A. (USA)

"Test Results on Safety on Jojoba Alcohol for Cosmetic Use"
TAGUCHI, M. (Japan)

SESSION 10 (14.30—16.30 hr.)

BIOLOGY, CHEMISTRY AND TECHNOLOGY OF JOJOBA OIL AND MEAL III

"Oxidation and Isomerization of Jojoba Oil"
GALUN, A. (Israel)

"Ozonization of Jojoba Oil"
ZABICKY, J. (Israel)

"Utilization of Defatted Jojoba Meal"
LISK, D.J., BROWN, J.H. (USA)

EXHIBIT "C"

DEPARTMENT OF AGRICULTURE,
OFFICE OF THE SECRETARY,
Washington, DC, March 7, 1984.

Hon. ROSCOE L. EGGER, Jr.,
Commissioner, Internal Revenue Service,
Washington, DC.

DEAR COMMISSIONER EGGER: On November 10, 1983 the Department of Agriculture wrote a letter requesting an opportunity to review the comment upon a proposed regulation, LR 144-76 (Farm Syndication Regulation) prior to action by your agency. We have not requested to appear before a public hearing on the proposed rule. Instead we are providing comments on the IRS proposed regulation and request this be entered into the record as the Department's position concerning the issue.

The Department of Agriculture, at this time, is opposed to the proposed tax classification action of jojoba, an arid land plant that is grown in the Southwest. The Department takes the position that the IRS proposal would impede the development and potential commercialization of a number of crops that have strategic and industrial application.

In the case of jojoba, the application is an additive to highly specialized lubricants, a replacer for sperm whale oil. Sperm whales are an engangered species and the United States no longer imports nor includes this oil in the strategic stockpile. Jojoba appears to be the most viable alternative for replacing a commodity for which there are strategic and industrial implications.

A Critical Materials Task Force has recently been appointed in USDA to determine the economic feasibility of producing a number of crops that are capable of providing botanochemicals to replace imported petroleum used for feedstock in the chemicals industry. The United States finds itself dependent on foreign sources for nearly half of its petroleum supply, of which about 400,000 barrels per day are utilized as feed stock in the chemicals industry.

We would further point out that the Department has in effect a Master Memorandum of Understanding with the Department of Defense. Under this agreement, research of mutual concern will be conducted and the work carried out under the terms of this agreement will be significant benefit to the United States. One of the specific areas of work will be concerned with strategic and critical materials. We feel that research on strategic materials under this agreement could be significantly impeded if the IRS proposed regulation is implemented.

It is realized that the Internal Revenue Service has a concern to fairly and appropriately collect taxes on commercial agricultural operations. It is also realized that jojoba is being commercially produced for the cosmetics industry. If this were the only application for jojoba oil the Department's view would, in all probability, be different. The implications for strategic and industrial application and the potential that jojoba, along with a number of other crops, has as a new agricultural commodity justifies the Department's reluctance to favor a change in the tax status of jojoba at this time.

We would favor a delay in this decision pending the outcome of not only the Department's Critical Materials Task Force but a thorough study by the Federal Emergency Management Agency (FEMA).

FEMA has the responsibility for assuring materials in the strategic stockpile for national emergency and is concerned that presently it does not have a stockpile replacement for sperm whale oil. FEMA also has a concern for other materials which are petroleum based as well as natural rubber. In many cases the U.S. is highly dependent on foreign sources and is totally import dependent for natural rubber.

The issue, at this point, is not one of classifying jojoba as a commercial agricultural commodity, but an issue of determining its application as a potential strategic and essential industrial material. This, of course, will require a coordinated study by a number of Federal agencies.

We propose that a study be undertaken and that the Department of Agriculture work with FEMA and other key agencies to determine the applicability of jojoba as a strategic material. This coordinated study would be conducted after results of the Department's Critical Materials Task Force has provided its results and recommendations to the Secretary. It would also provide time to assess the industrial potential of certain agricultural crops and their applicability to non-traditional agricultural usages.

As was mentioned in our previoius letter, the Department has operated under the provisions of the 1981 Farm Bill and of PL 95-592, the Native Latex Commercialization and Economic Development Act. PL 95-592 has been rewritten and now is in the Senate under H.R. 2733, the Critical Agricultural Materials Act. With the passage of this Act we would be in an entirely different position of conducting research and developing a number of critical hydrocarbon-containing plants including jojoba for oil, guayule for natural rubber, and other plants that produce materials essential to the Nation's industries.

We are reluctant to see action taken to impede the research and development of potential agricultural commodities that could aid the farming sector and contribute, as well, to the industrial economic capacity of the United States.

Sincerely,

ORVILLE G. BENTLEY,
Assistant Secretary.

Chairman **STARK**. Thank you very much.

I gather that there is some semantic discussion going on between the botanical definition of jojoba, that is the seed of a fruit, and the horticultural definition evidently being somewhat different. That is a matter of indifference to me.

It also is a matter of indifference, and I certainly would be the last to suggest that the oil of the jojoba bean, fruit, nut, whatever it is, may have both curative, restorative and lubricating products far exceeding anything we know. That, again, is not of concern to me or a concern of the committee.

What I would like any of you to explain is, as briefly as you can, is why we should treat the jojoba bush-bean-tree—whatever it is—any differently than we treat walnuts, pistachios, grapes, or any other agricultural product that takes a while to grow? Why should we give a special break to jojoba farmers?

Ms. **WHITTAKER**. Because——

Mr. **KNOWLES**. I was just going to say I tried to answer that in my presentation. I think the major difference is that each one of these other crops you mentioned had been grown commercially, if not in this country, in another country, and they are much more predictable.

Chairman **STARK**. I will give you examples where that is not at all the case in a moment. But go ahead.

Ms. **WHITTAKER**. The point is that in the case of jojoba, we are not taking a crop which we understand well, and where we have a rulebook. We are——

Chairman **STARK**. Good, this is a new crop.

Ms. **WHITTAKER**. Absolutely new. Everything you do is——

Chairman **STARK**. Let me take such a conservative free enterprise as Mr. Knott, of Knotts Berry Farm, who without a nickel of Government subsidy developed boysenberries which were not a crop; or after avacadoes in the State of California were practically nonexistent in the 1930's and now are desired and valuable throughout as a vegetable, whatever they are. Victor Borge, an immigrant, came to this country and in the grandest tradition of agriculture developed the cornish game hen in the State of Connecticut without any Government subsidies.

Grapes are now being grown once again—although, admittedly, 200 years ago they were grown in Virginia—but they have had to redevelop a whole new root stock and grafting and a type of grape that would grow in States where they have not grown before. We give them not the treatment.

That is the question I have. I don't intend to give them the treatment, by the way. I would state for the record that I have developed vineyards and still have some, and I don't get this. I think this is an extra tax subsidy. I don't think it is needed. I would admit you can make money, and it is a wonderful crop, but I don't see that—we have never given it to any other agricultural product. Why should we start now?

If somebody can answer that——

Ms. WHITTAKER. I would say none of the crops you mentioned are necessary. No one needs boysenberries or grapes. We can live without them.

The question here is, Is jojoba oil something which is of intrinsic value for the well-being of this Nation? Is it a product——

Chairman STARK. If it is in the best order of free enterprise, that is what we let the marketplace determine.

Mr. KNOWLES. Mr. Chairman, I think maybe the answer to that question is that the Congress many times in the past has offered tax incentives where they felt it was necessary to develop that particular crop or industry, and I think the fact that Congress didn't eliminate the tax for all agricultural crops in the 1976 act is an indication they still want to provide some tax incentives for these agricultural crops.

Chairman STARK. I don't know that there is any test, and the Chair would welcome it later, that showed that any of our tax laws were ever designed to assist the jojoba industry, sperm whale oil was knocked out as an import in 1971, long before the 1976 act, and there was nothing in the 1976 act to my recollection that dealt with helping sperm whale being imported.

So I don't think that that is an—that is a convenient history, but we have never in the history of this country, since we gave free water to all the farmers in California, really tried to generate a subsidy to help somebody develop.

There are universities, in addition to Davis at California, developing new agricultural plants and products and animals all the time. We just passed a law, we had a great argument last year about patenting new agricultural seeds and products. There has never been a suggestion that we should give that a tax credit to help it out. So that is my issue.

What I am concerned about is that this is—there is absolutely no way you can deny this credit to other agricultural interests in the sense of fairness, and I don't think really that you have made a case—not that jojoba isn't a useful, wonderful product—but there is no—we have not heard from the Defense Department that they are screaming for it. The astronauts don't want to take your hair-growing oil up into space with them to do something there with it.

There is some contest on the cookies. Dr. Braunder's magic soap probably sells very well, but I don't know that we ought to subsidize this kind of stuff any more than Knotts Berry Farms' boysenberries or California or Florida avocados and/or, I might add because I can't let the record go without saying, there is a very large element, thank God, in this country who thinks that grapes are very essential to their life and whether they are in the form of table grapes or in the glass, the elixir of the Gods, which we produce in California.

They love it, believe me, this would be a boon to the grape industry if we could have this kind of deduction, but we don't. I think that is the—I apologize for anything that might suggest the least bit of even—I won't use the word "ridicule"—but we are just strictly concerned with where we spend the taxpayers' money and whether or not the tax shelters should be or shouldn't be there.

I agree, they are proliferating in your industry, and one only has to look at the advertisements in the Wall Street Journal or elsewhere to see that people are peddling tax shelters. That is really what brought it to the attention of this committee, and I would hope that we would have you wait to take your depreciation investment tax credit when the orchards start to produce the income.

As to Mr. Shooter's comment, we will deal next year with ways to close the deficit so that by 1999, or whenever you show we lose money here, we will probably find a way to get that.

I would like to welcome the ranking minority member of our subcommittee, Mr. Duncan, and ask if any other members, too, have questions?

Mr. DUNCAN. I have no questions, Mr. Chairman.

Chairman STARK. Thank you.

I want to call our next witness, Senator John Melcher from the great State of Montana, who would like to testify ahead of his panel. He has pressing business. I hope his business will be so pressing so he can get us out of here, so we can get home this weekend.

With an eye toward seeing the Senate finish their business this week, John, welcome to the committee. Welcome back to the House Office Buildings, and we have your prepared testimony. It will appear in the record in its entirety, and you may proceed as you wish.

STATEMENT OF HON. JOHN MELCHER, A U.S. SENATOR FROM THE STATE OF MONTANA

Senator MELCHER. Thank you, Mr. Chairman, and I appreciate this opportunity to testify before you and my former colleagues.

I often miss the House action and procedures of the House and the more definite time for adjournment that the House seems to be able to set than we are able to set in the Senate.

I will be very brief this morning because I am not coming here on an issue that is new to the American people, those in the construction business, to the chairman, or to the House. It is an old subject. It is an old subject and old inequity in our tax structure.

We have had the very glaring examples of court cases that reach fruition where construction workers win their day in court after long trials and tribulations to get there, a rather costly procedure I might add, too, to prove that their expenses to get to a job a long ways from their home is indeed a legitimate expense and deductible under the law, and IRS will have to allow it.

Since 1981, we have been tussling with this in the Senate, hoping to clarify the law so that construction workers will be treated like ordinary taxpayers and will be able to list their expenses away from home and treat them as a deduction.

In 1982, we were successful in passing a sense of the Senate resolution as part of the highway tax bill directing the IRS to study the question of deducting construction workers travel expenses and to come up with a series of recommendations.

It was only the sense of the Senate resolution, and I guess it is all right for the Treasury to ignore it, but as far as I have been able to determine, there never was a study conducted. We are still in the gray area here now of what is available and when it is available as a deduction for construction workers.

I don't think this is fair. I don't know why we should treat construction workers and their families as if they are somehow a family of gypsies that continue to want to move from home to home, and that is the way they want to design their life; so, therefore, they are not entitled to the ordinary business deduction.

I don't know any reason why we should treat construction workers as less than first-class citizens, less than first-class taxpayers. You and I have some restraints on us because we are Members of Congress, and we have set in the statutes some limitations on what we can deduct for our use of a home here. But that is a very, very narrow statutory prohibition.

In our own private lives, in business, we are accustomed to deduct as business expenses those expenses that are incurred away from home overnight. We don't have to argue about it. We know how to keep the records, and our accountants know how to put it on our tax forms.

That isn't true with the construction workers. This is a long-time grievance, Mr. Chairman, an injustice for those workers. Their families are entitled to not have to be placed in the position of moving every year or else the breadwinner—he or she or both—will not be able to have legitimate deductions for business expenses under IRS regulations.

Well, the IRS regulations are the responsibility of the Department of Treasury based on the laws that we pass here in Congress. We have a House bill over here, H.R. 700, and we have a Senate bill that I introduced with several cosponsors that is S. 1219. I think your bill is probably more meritorious than mine, because it says 30 miles away from home is away from home. We say 40 miles, but we establish the guidelines very easily and simply for both the construction workers to understand, IRS to understand, and the courts to be able to interpret.

I certainly urge as prompt action as possible in the next Congress on this. I hope that both the House and the Senate can correct this longstanding injustice for construction workers. Thank you.

Chairman STARK. Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman.

Senator Melcher, are you familiar with the *Frederick* case?

Senator MELCHER. Yes, I am aware of the *Frederick* case.

Mr. DUNCAN. In that case the court ruled that workers were entitled to away-from-home expenses. However, the IRS has not followed it in any other jurisdiction. Doesn't the bill reach the same result as the *Frederick* case?

Senator MELCHER. Yes, it does. That is right. Currently, the IRS refuses to acknowledge the *Frederick* decision.

Mr. DUNCAN. Thank you very much, sir.

Chairman STARK. Any other questions?

Senator, thank you very much. I would like to say that great minds run in the same direction. I would claim authorship for H.R. 700, and I hope that we will be able to maybe compromise at 35 miles. Maybe we can bring some relief——

Senator MELCHER. I would rather have your 30 miles.

Chairman STARK. But thank you very much for your testimony today, and see what you can do to get us out of here this weekend?

Senator MELCHER. All right, thank you very much.

Chairman STARK. Thank you.

We have a man who would like to testify on this same topic, and—is Congressman Morrison here? Come up, if you would, I am sorry. I didn't see you.

I am looking for Dr. Andrew Graham, if he is in the audience, if you would identify yourself to our staff, I would appreciate that.

Do we have your prepared testimony?

Mr. MORRISON. Yes, you do, Mr. Chairman.

Chairman STARK. Good. It will appear in the record, and you may add to it or however you see fit, you may proceed.

STATEMENT OF HON. SID MORRISON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Mr. MORRISON. Thank you very much, Mr. Chairman.

I appreciate this opportunity to appear on an issue that has become of increasing significance in my district and, Mr. Chairman, I have been pleased to follow your lead and serve as cosponsor of H.R. 700 and compliment you for that.

I would like to make a few points, emphasize a few points that are in my testimony.

I believe that Mr. Bob Georgine is here, of the building and construction trades. I have worked with that particular group now for the years I have been involved in Congress on an increasing basis, first with individual members and then collectively with them as they have brought to me the inequities that exist under present IRS procedures on travel cost deductions for construction workers.

This is a frustration that is growing for me because of the inconsistent and arbitrary manner in which they have applied these rules to workers in my area. Workers have not qualified for tax exemptions as I believe that they should. The IRS has applied the arbitrary hindsight test, the 1-year rule which you have attempted to clarify, and do very well, in H.R. 700.

IRS did modify the 1-year rule to call it a one-plus-one, but the new ruling doesn't really help construction workers claim their travel deductions. It is sort of a smoke screen, in fact. While it establishes a rebuttable presumption, they do end up having to go through costly and time-consuming litigation to get a result.

Mr. Chairman, I would opine that for construction workers, maybe the 1-year rule may have been appropriate in years past. But now in my area, we are building nuclear powerplants and other complex facilities, and we find that temporary construction jobs are shifting from contract to contract and are lasting for longer periods of time. It now takes longer to build some facilities than some things that have come in America's past.

I listened to the Treasury folks testify this morning, and they said they didn't like your bill because it created a partiuclar class and gave them a different type of treatment. Mr. Chairman, I would opine for the committee that the penalty which, in effect, they now apply to construction workers, applies to a particular class of people. They seem to be singled out, as Senator Melcher has very clearly indicated.

So I feel that your bill is a vital step in the right direction. I would also mention to the committee that along with the other seven members of the Washington State delegation, I introduced H.R. 5807, which builds on your base as established in H.R. 700. It adds one additional test, a hardship test for construction workers, that I think is worthy of consideration by the committee.

In my district, particularly in my district, we have construction workers who have no choice but to travel, and I am sure this is repeated in other places across the country. This would be a permanent exemption to the overnight standard in the Tax Code, would allow travel deductions for construction workers in those cases where the job site is remotely located, at least 30 miles from the home, as you provide in your bill, and not near residential or reasonable support facilities.

The specific example I site included in my district is a 570-square mile Hanford nuclear reservation on which, for security reasons, there are absolutely no living facilities. There probably never will be as long as it is used in that manner. Right next door to that center is a 540-square mile Yakima firing center used now to simulate combat conditions in the Middle East and in which construction is also going on. We find workers have absolutely no choice in traveling to work sites and job sites in these facilities.

So there is a hardship potential which should also be considered in those cases where Government decisions have prohibited an opportunity for people to live in any area near the job site. IRS decisions have not allowed these people to bring class action suits, and individually their tax loss per year is $1,500 to $1,700, not enough to pay for the expensive litigation to proceed with the court challenge which Representative Duncan raised in his questions to Senator Melcher.

I compliment you on your leadership, Mr. Chairman. I think the committee could go one step further and commend you for your interest in what I consider to be a gross inequity for America's construction workers.

[The prepared statement follows:]

STATEMENT OF HON. SID MORRISON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Good morning, Mr. Chairman and Members of the Subcommittee. I appreciate this special opportunity to testify on H.R. 700, legislation which clarifies the circumstances under which construction workers may deduct travel and transportration expenses from their taxes.

I salute the Chairman for sponsoring this important legislation, which I'm proud to cosponsor, and for holding this hearing. I'm also delighted and honored to be here in the fine company of Senator John Melcher and Mr. Bob Georgine of the Building and Construction Trades of AFL-CIO.

The current tax law and IRS regulations on this matter are confusing and subjective. Many of the my constituents have expressed frustration and outright disgust with IRS's arbitrary and inconsistent interpretation of the law. Thousands of construction workers who live in rural, sparsely populated eastern Washington travel scores of miles a day round trip to reach their construction jobs. Furthermore, many of the workers have been laid off from various jobs and been employed by several different contractors. Despite the inherent transitory nature of construction and the fact that these jobs have all the characteristics of being "temporary," many construction workers have not qualified for tax exemptions for their travel expenses.

The IRS's authority for denial of these legitimate travel deductions is an arbitrary hindsight test, the one-year rule (Revenue Ruling 59-371) in which travel deductions are disallowed if the job lasts more than a single year. The IRS recently modified the one-year rule to make it a "one-plus-one" rule in which a rebuttable presumption would apply during a second year. While this new IRS rule (Revenue Ruling 83-82) is an improvement, it does little to help construction workers claim their travel deductions. The new rule is actually a smoke-screen; in practice, the taxpayers must accept the one-year rule unless they are willing to challenge the rebuttable presumption by resorting to costly and time-consuming litigation.

H.R. 700, in sharp contrast, takes a sensible and fair approach to remedying the current subjective and inconsistent IRS interpretation of the law. The bill establishes an understandable and uniform standard: construction workers living more than 30 miles from their job site can deduct travel expenses for the first *two* years of their employment at that job. This standard does not depend upon an after-the-fact determination—nor does it penalize those construction workers who have been laid-off. Instead, this proposed statutory test gives otherwise confused taxpayers an unambiguous and consistent measure of whether they qualify for travel tax deductions.

While I fully support H.R. 700, I believe that this legislation can be built upon. In June, along with seven other Members, I introduced H.R. 5807 which is aimed at further clarifying the treatment of travel expenses for construction workers. H.R. 5807 retains the temporary test outlined in the Subcommittee Chairman's bill: it allows construction workers living more than 30 miles from their job site to deduct expenses for the first two years.

My legislation, however, goes a bit further by adding a "hardship" test for construction workers who are compelled to work at temporary or remote job sites. The new hardship test would be a permanent exception to the oversight standard in the Tax Code (section 162). Specifically, it would allow travel deductions for construction workers in those instances where the job site is remotely located (at least 30 miles from the construction worker's home) and not near residential or reasonable support facilities.

A federal job site in my congressional district provides an excellent application of the hardship test. The job site is the Hanford nuclear reservation, a 570-square mile complex which for national security reasons is remotely located in south central Washington. Many of the construction workers at this site have little choice but to live more than 30 miles from their jobs because there are no living accomodations on the site itself, nor can there be.

Many other parts of country have similar isolated construction sites. In this these situations where construction workers are obligated to work in these remotely located sites, they should be accorded a deduction for their travel expenses. This new deduction compensates for the hardship thrust upon construction workers which, by the way, is often caused by a government decision to isolate a job site.

I hope that the Subcommittee, as early as possible next year, will favorably review the merits of H.R. 5807 and consider incorporating some its provisions—particularly the hardship test—when the construction worker travel deduction issue is addressed.

Thank you for your attention. I would be delighted to answer any questions you may have.

Chairman **Stark**. Sid, thank you very much. I share with you the vexation in seeing how this dragging on and your suggested changes may have real merit, and I am hoping that while I don't see the chance of getting it done this year, I hope we can get at this first thing out of the box next year. I appreciate your coming.

Mr. **Duncan**. I want to thank our colleague, Mr. Chairman, and I think this is good legislation. We certainly appreciate your contribution to the discussion. Thank you.

Mr. **Morrison**. Thank you.

Chairman **Stark**. Mrs. Kennelly.

Mrs. **Kennelly**. No questions, Mr. Chairman.

Chairman **Stark**. Is Robert Georgine in the audience?

If not, how about William Jones?

Mr. Georgine is running late, so we will take you, Mr. Jones, at this time. We have a copy of your testimony, and without objection it will be made a part of the record in its entirety.

I am not sure we will get your picture in so clearly, but we will try. And if you would like to summarize or expand on your testimony, you may do so.

STATEMENT OF WILLIAM R. JONES, PRESIDENT, NATIONAL CONSTRUCTORS ASSOCIATION

Mr. **Jones**. Thank you very much, Mr. Chairman.

I appreciate the opportunity to appear here this morning in support of H.R. 700.

I am president of the National Construction Association, a Washington-based trade association representing most of the Nation's largest unionized engineering-construction firms. We appreciate this opportunity to appear before you today to express our support for H.R. 700, a much-needed clarification of existing tax policy which addresses the treatment of worker travel expenses to and from distant construction sites.

Mr. Chairman, we are a labor-intensive industry. Construction firms rely on a secure, dependable source of skilled and nonskilled workers for virtually every aspect of their operations. Members of the National Constructors Association, engaged for the most part in industrial engineering and construction activities, are operating in virtually every part of the country. Our workers, hired through the Building and Construction Trades Department of the AFL–CIO, are often required to travel substantial distances on a regular basis, or even temporarily relocate for an extended period of time, in order to perform the most basic construction operations. The ability of our member companies to ensure that these workers are willing to travel to and from construction sites has a great deal to do with the feasibility of the project itself. It can also have a major impact on the cost of that project to the client as in the case of power generation facilities, which greatly impact businesses and private citizens who rely on the energy produced.

We are pleased to join Senator Melcher, Congressman Morrison, and Mr. Georgine from the building trades department in urging adoption of H.R. 700.

As an employer group, the National Constructors Association can understand and appreciate the frustration current IRS policy—or lack of it—brings to construction workers on our projects. Any number of factors may impose long delays on a given construction project, delays which, unanticipated by management or workers, may well push the project duration beyond the current IRS 1-year rule. Unforseen equipment delivery delays, adverse weather conditions, design changes, scarcity of skilled craftsmen, regulatory snags, and other bureaucratic delays are only a few of the factors which may affect the project completion date. Many of these outside, often uncontrollable factors may have the effect of eliminating the deducibility of a construction worker's legitimate travel expenses to a construction job site.

It can also have an impact on construction companies as well. Uncertainty over what may be deductible and what may not create understandable problems for accounting divisions trying to determine withholding liability.

And with the scarcity of skilled craftsmen in some remote areas a potentially critical factor in the timely, cost-effective completion of a project, uncertainty regarding travel deductions can only compound the problem.

Mr. Chairman, our statement for the record cites two examples which we feel useful in demonstrating the distances which many construction workers must travel on a regular basis. The examples also describe the lengths of time that are often required to complete major projects which, although longer than a year in duration, must be regarded as temporary. We had a project in the upper Midwest that peaked at 5,000 construction employees. Sixty percent of the employees in that project were there in excess of 1 year; 30 percent of the employees were on the project in excess of 2 years. The tremendous fluctuation in manpower requirements over the life of a typical industrial project makes it unrealistic to limit the definition of "temporary" to 1 year, especially when it is impossible for an individual construction worker to know in advance whether his employment will be for the life of the project or will terminate as the typical peak demand is met at about 80 percent of project completion.

The unique manpower demands of the construction industry make an excellent case for enactment of H.R. 700. Our industry places unique demands for manpower which require a very flexible, often mobile workforce. If we are to expect those manpower needs to be fulfilled, that work force must be willing to travel to often remote areas for periods of uncertain duration. H.R. 700 will remove much of the uncertainty for construction workers seeking to deduct their legitimate expenses traveling to these temporary worksites. The National Constructors Association is pleased to support this legislation and urges this subcommittee to support its enactment.

Mr. Chairman, let me thank you again for your interest in this legislation and for the opportunity to present our views.

[The prepared statement follows:]

STATEMENT OF WILLIAM R. JONES, PRESIDENT, NATIONAL CONSTRUCTORS ASSOCIATION

Mr. Chairman and Members of the Subcommittee, I am William R. Jones, President of the National Constructors Association, a Washington-based trade association representing the nation's largest unionized engineering-construction firms. We appreciate this opportunity to appear before you today to express our support for HR 700, a much-needed clarification of existing tax policy which addresses the treatment of worker travel expenses to and from distant construction sites.

Mr. Chairman, we are a labor-intensive industry. Construction firms rely on a secure, dependable source of skilled and non-skilled workers for virtually every aspect of their operations. Members of the National Constructors Association, engaged for the most part in industrial engineering and construction activities, are operating in virtually every part of the country. Our workers, hired through the Building and Construction Trades Department of the AFL-CIO, are often required to travel substantial distances on a regular basis, or even temporarily relocate for an extended period of time, in order to perform the most basic construction operations. The ability of our member companies to ensure that these workers are willing to travel to and from construction sites has a great deal to do with the feasibility of the project itself. It can also have a major impact on the cost of that project to the client as in the case of power generation facilities, which greatly impact businesses and private citizens who rely on the energy produced.

We are pleased to join Senator Melcher, Congressman Morrison, and Mr. Georgine from the Building Trades in urging adoption of HR 700. HR 700 would define the criteria by which construction worker travel expenses would be tax-deductible. Travel expenses to job sites at least 30 miles from a construction worker's principal place of residence for a period of less than two years in duration would qualify as deductible. Furthermore, travel expenses for jobs lasting more than two years could be deemed deductible on a case-by-case basis without regard to the employee's first two years of employment at that job site.

Most importantly, this legislation specifically notes that the deduction of travel expenses by construction workers shall not be disallowed solely because the construction worker's employment at a job site is of "indefinite duration."

These provisions recognize that construction industry employment is often temporary and transient, and accordingly provides reasonable standards for determining the deductibility of related travel expenses. Both the construction worker and his employers will benefit from this clarification.

The most recent guidelines from the Internal Revenue Service on this issue, Revenue Ruling 83-82, was helpful, but nevertheless left many uncertainties. That ruling allowed or prohibited travel expense deductions based on three principal criteria:

(1) The nature of the travel expenses;
(2) The length of the employment, and
(3) The substantiality of the employee's abode.

According to this ruling, employment must be classified as "temporary" in order for the travel expenses to be deductible. Employment is defined as "temporary" if it is expected to last less than one year or, in certain circumstances, if it exceeds one year but is less than two years in duration. Jobs greater than one year in duration are considered "indefinite" or permanent unless the employee can demonstrate that:

(1) He expected the job to last less than two years;
(2) He would return to his claimed tax home when the job was complete, and
(3) The claimed tax home is the worker's regular place of abode in a real and substantial sense.

The ruling holds further that all jobs longer than two years in duration would disqualify the worker from receiving travel expense deductions.

It is important to note that the IRS has not only held most of these cases to a strict "one year rule" in the past, but has also found that the first year's travel deductions could be disallowed retroactively when the worker continued at that job site for the second full year.

Mr. Chairman, we consider the arbitrary one-year rule to be unjustified and often unfair in light of the uncertain nature of construction industry employment. As an employer group, the National Constructors Association can understand and appreciate the frustration this brings to construction workers on our project. Any number of factors may impose long delays on a given construction project, delays which, unanticipated by management or workers, may well push the project duration beyond the current IRS standard. Unforeseen equipment delivery delays, adverse weather conditions, client-instigated design changes, scarcity of skilled craftsmen, regulatory snags, and other bureaucratic delays are only a few of the factors which may affect the project completion date. Many of these outside, often uncontrollable factors may have the effect of eliminating the deductibility of a construction worker's legitimate travel expense to a construction job site.

As mentioned earlier, it can also have an impact on construction companies as well. Uncertainty over what may be deductible and what may not creates understandable problems for accounting divisions trying to determine withholding liability.

And with the scarcity of skilled craftsmen in some remote areas a potentially critical factor in the timely, cost-effective completion of a project, uncertainty regarding travel deductions can only compound the problem.

A project which demonstrates the travel requirements often faced by construction workers was recently completed in the upper midwest. The project was in a remote site with the nearest large city being eighty-five miles away. Because of its remoteness, the contractors established a camp to accommodate 1000 craftsmen. Construction began in earnest in early 1981—the construction craft manpower peaked at 5000 in 1983. Of the 4000 craftsmen not in the camp, two-thirds were residents of that state—most of whom travelled to the job site. Because of the distances required—two towns 85 miles away and one town 110 miles away, the majority of these person found temporary housing closer to the project and would remain there during the work week. Temporary housing consisted of motels, private homes, shared trailers, campers and the like. During the life of this project our member companies' best estimate is that 60% of the craftsmen were employed in excess of one year, with 30% being there in excess of two years.

From an employer's standpoint, Mr. Chairman, the fulfillment of manpower requirements for a major project is of course critical to its timely completion. And when you examine the typical labor requirements for the types of projects routinely performed by the NCA membership, the use of construction workers for periods exceeding one year but varying in duration up to and exceeding two years is routine. The following example will help illustrate this point.

A recent single-unit power plant construction project completed by one of our companies had the following typical manpower profile:

First month, 40 construction workers;
Third month, 240 construction workers;
Sixth month, 460 construction workers;
Ninth month, 670 construction workers,
Twelfth month, 675 construction workers;
Fifteenth month, 660 construction workers;
Eighteenth month, 630 construction workers;
Twenty-first month, 365 construction workers;
Twenty-fourth month, 160 construction workers;
Twenth-seventh month, 70 construction workers.

Furthermore, some crafts may contribute 3% of the work force in the early phase of construction and expand to 35% of the work force at peak project employment. This shows the tremendous fluctuation in manpower requirements for a typical project. Given that there can be several types of construction projects going on at any time, it can be readily seen that construction workers must respond to constantly changing travel requirements if manpower needs on construction projects are to be met.

I'd like to add that it is almost impossible for an individual construction worker representing a single craft to determine whether his employment will be for the file of the project or will terminate as the typical peak demand is met at about 80% of project completion.

Travel to and from remote job sites can involve hardship and uncertainty for management employees as well. HR 700, however, specially excludes such workers from coverage. We urge the Subcommittee to consider revising this legislation accordingly so that foremen, supervisors, and other management-level workers are able to benefit from it.

I've included as an appendix to this statement two graphs illustrating labor demand distribution for nuclear electric power plan construction by craft and the construction schedule by unit within the facility. These are excerpted from a Department of Labor/Department of Energy report on Labor and Capital Requirements for Constructing Electric Generating Power Plants of January 13, 1978. Although somewhat dated, these graphs show clearly the curve of mampower needs for a typical nuclear plant construction project which may extend over four or five years. Peak manpower needs may extend over only 40% of that construction duration or for a period probably exceeding one year but less than two.

I think these examples demonstrate the unique manpower demands of the construction industry and make an excellent case for enactment of HR 700. Our industry places unique demands for manpower which require a very flexible, often mobile workforce. If we are to expect those manpower needs to be fulfilled, that workforce must be willing to travel to often remote areas for periods of uncertain duration. HR 700 will remove much of the uncertainty for construction workers seeking to deduct their legitimate expenses traveling to these temporary worksites. The National Constructors Association is pleased to support this legislation and urges this Subcommittee to support its enactment.

CONSTRUCTION SCHEDULE FOR NOMINAL NUCLEAR ELECTRIC POWER PLANT (2 UNITS)

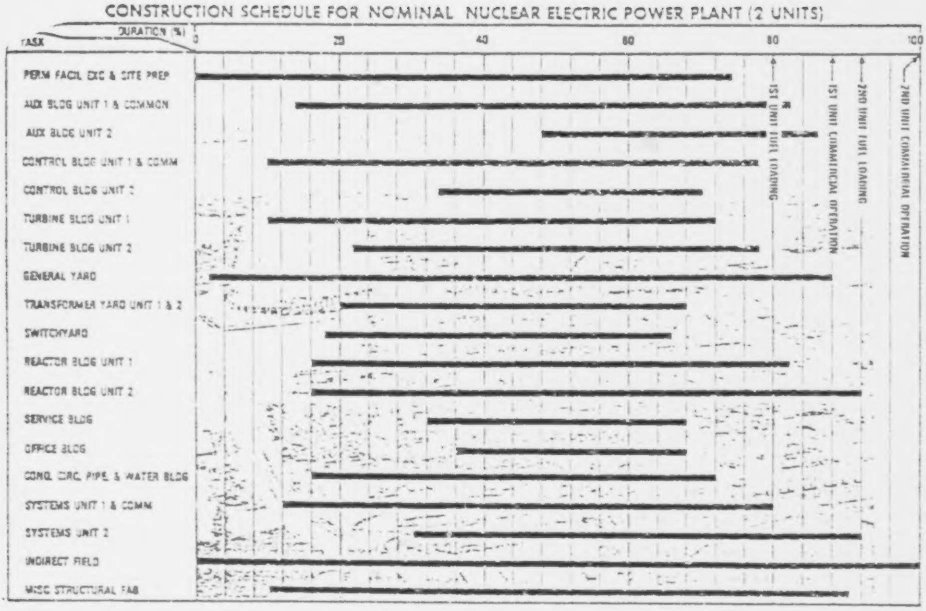
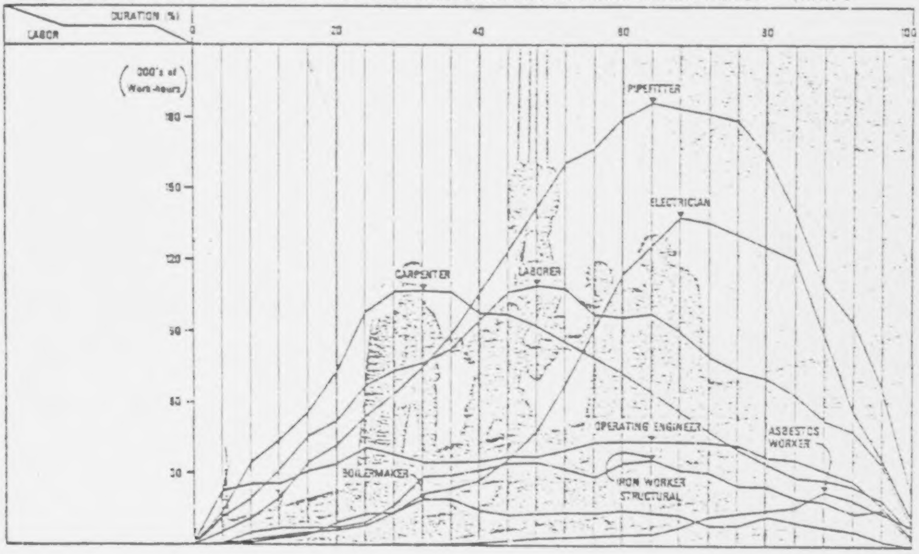


FIGURE 5

LABOR DEMAND DISTRIBUTION FOR NUCLEAR ELECTRIC POWER PLANT CONSTRUCTION (UNIT 1)



Chairman **Stark**. Thank you very much, Mr. Jones. We appreciate your support for our legislation.

Mr. **Jones**. Thank you.

Chairman **Stark**. If Mr. Georgine has not arrived, we will proceed to our next panel: Mr. Douglas P. Bennett and Mr. Humphrey Taylor.

Mr. Bennett, we have your prepared testimony and it will appear in its entirety in the record. You may proceed in any manner you desire.

STATEMENT OF DOUGLAS P. BENNETT, COUNSEL, NORTH AMERICAN, INC., INTERNATIONAL CATERING CORP., AND JACQUES BOREL ENTERPRISES, INC.

Mr. **Bennett**. Thank you, Mr. Chairman. Good morning.

Good morning, Mr. Duncan.

I am Douglas P. Bennett a partner in the law firm of Powell, Goldstein, Frazer & Murphy, located in Washington, headquartered in Atlanta, GA. I have been involved in the development and advocacy of this concept for a number of years since its inception and introduction by Congressman Guy Vander Jagt. Incidentally, Mr. Vander Jagt just indicated to me that he had a statement he wished to put in the record, and asked me to mention that.

Chairman **Stark**. Without objection, we will add that statement to the record.

[The statement appears in the appendix.]

Mr. **Bennett**. What I will try to do for just a few minutes, rather than read my statement, is summarize some significant points. I will dwell principally on the tax policy aspect of this concept, and ask, at the appropriate time, that you will also accept into the record some economic analyses that we have done relative to this concept.

Chairman **Stark**. Without objection.

[The information follows:]

Congress of the United States,
Joint Committee on Taxation,
Washington, DC, November 5, 1982.

Hon. John J. Duncan,
House of Representatives,
Washington, DC.
(Attention: Patrick Willard.)

Dear Mr. Duncan: This is in response to your request for the estimated revenue effects of H.R. 2173. The bill would amend section 119 of the Internal Revenue Code to provide that under certain conditions meals furnished off the business premises of an employer would be considered furnished for the convenience of that employer. Thus, the value of such meals would be excluded from gross income of the employee.

If the bill were effective for taxable years beginning after December 31, 1982, the estimated revenue loss would be the following:

Fiscal year	*Millions*
1983	$29
1984	55
1985	64
1986	68
1987	72

These estimates do not account for possible "feedback" effects attributable to the proposal. To do so would require that we trace a multitute of interactions and secondary effects that would impact not only the restaurant industry, but also many related sectors of the economy. Therefore, while we recognize the potential for various secondary effects, we feel that it would be extremely difficult to quantify them effectively.

Sincerely,

MARK MCCONAGHY.

SUMMARY OF ECONOMIC EFFECTS

	1982	1987
Work force	100,397,000	109,700,000
Employee meals per day (0.4 percent of work force)	401,588	438,800
Average value of meal	$2.63	[1] $3.36
Number of meals per employee year	230	230
Value of meals per year (thousands)	$242,920	339,105
Total new business produced in eating establishments, including cash payments (thousands)	$206,482	288,239
Jobs created	−7,237	−7,915
	10,721	11,726

[1] 5 percent inflation factor

The following analysis is computed as of 1987 when it is assumed that the employee meal system will be fully implemented

	Thousands
Estimated Static Federal Revenue Loss	−$72,060
Income tax	−37,302
Payroll tax	−34,758
Estimated feedback Federal revenue gain	47,623
Income taxes paid by eating establishments	17,294
Income taxes paid by new employees	12,308
Payroll taxes	18,021
Total estimated Federal revenue consequence	−24,437
Estimated State tax revenue consequence	35,513
Total estimated Federal and State revenue consequence	11,076

CONCLUSIONS

In terms of the average work week in the restaurant industry of 27 hours:

(a) Discounting feedback revenue, the creation of one job will cost $72,060,000/11,726=$6,145.

(b) Counting feedback revenue at the federal level, the creation of one job will cost $24,437,000/11,726=$2,084.

(c) Counting feedback revenue at the Federal and state levels, the creation of one job will earn $11,076,000/11,726=$945 per year.

ECONOMIC CONSIDERATIONS

In estimating tax revenue implications, a few assumptions have been made in part predicated on European experiences, which in view of the similarities of economies, can be considered as reasonable indications of the results that implementation of the employee meal system will have in the United States. Since the employee meal system was started in Great Britain in 1948, nine Western European countries, Brazil, Mexico and Argentina have adopted legislation similar to that proposed.

Employee meals in the United States

The principal assumptions are:

0.4 percent of the work force will participate in the employee meal system. (Source: This assumption was developed by the Treasury Department and the Joint Committee on Taxation for revenue estimation purposes.)

65 percent of the participants in the employee meal system will be new business for eating establishments as they were formerly brown bagging, skipping lunch or returning home. In Paris the estimate is 77 percent.

20 percent is spent above the value of the employee meal by the employee receiving the meal. Because of the economic support given by the employer, the employee will tend to spend more. Estimates in Europe are that participants spend an additional 25 percent in Great Britain and between 25 and 70 percent in France above

the value of the employee meal. As a conservative approach 20 percent has been estimated in the assumptions for the United States.

Average value of the employee meal is $2.63. One-half paid by the employer and one-half by the employee. (Source: Foodservice industry survey for the year ended August 1982 estimated to be $3.36 in 1987, the fifth year with a 5% inflation/year factor.)

Each employee will receive 230 employee meals per year (because of vacation, holidays, sick days, etc.).

U.S. Work force (January 1987)	109,700,000
Number of employee meals per day assuming system is in full operation (0.4 percent of workforce)	438,800
Total value of employee meals per year (438,000 × $3.36 × 230)	$339,105,000

Federal revenue loss

In calculating this revenue estimate, two fundamental assumptions were made so as to correlate assumptions and methodology to that of the Treasury Department.

1. In estimating revenue loss, it is assumed that the amount contributed by the employer but not deemed income to the employee is in the form of a non-taxable wage.

2. The average employee marginal Federal income tax rate (based on median income) is assumed to remain consistant at 22 percent through 1987.

Average marginal Federal income tax rate on wages—22%.

	Thousands
Value employee meals per year (000)	$339,105
Share paid by employer and not imputed income to employee (000) in 1987 ($339,105 × 50%)	169,552
Total Federal Revenue Loss (000) ($169,552 × 0.22)	37,302

FICA and unemployment taxes

FICA is paid ½ (6.7%) by the employer and ½ (6.7%) by the employee. The 6.7% rate is assumed to rise to 7.15% for 1985-1987. Unemployment tax will increase from 3.8% to 6.2% in 1987 and is entirely paid by the employer. FICA plus unemployment taxes lost will then be:

	Thousands
FICA 14.3% of $169,522	$24,246
Unemployment tax 6.2% of $169,552	10,512
Total payroll taxes lost	34,758
Total estimated static revenue loss:	
Federal Revenue Loss on Income Tax	37,302
Federal Revenue Loss on Payroll Taxes	34,758
Total Income + Payroll Taxes Lost	72,060

Employment effects

The 0.4 percent of workforce participation in the employee meal system will result in a substantial increase of business and employment in eating places.

The 1982 estimated average hourly earnings for nonsupervisory restaurant employees is $4.08. Assuming a 40 hour work week over an annual work year of 50 weeks, the average annual wage for 40 hour/week employees is $8,160. ($4.08 × 40 hours × 50 weeks = $8,160) or $10,414 in 1987 money assuming a 5 percent inflation factor annually.

Average payroll in a restaurant is 28.6% of gross sales. (Source: National Restaurant Association. Restaurant Industry Operations—Report 1982 prepared by Laventhol and Horwath.)

The jobs created in restaurants by the employee meal system can be estimated as follows:

Jobs created = new business produced in restaurant × 28.6% of average salary of employees in restaurants.

	Thousands
Value employee meals per year	$339,105
New business produced in eating establishments (65 percent new clients + 20 percent cash) ($339,105 × 85%)	$288,239
Jobs Created—40 hour/week Equivalent ($288,239,000 × 28.6% divided by $10,414)	7,915

While it is estimated that 7,915 new 40 hour/week equivalent jobs will be created, it should be noted that in consideration of the average restaurant industry employee work week of 27 hours, the number of newly created jobs would rise to 11,726. *This estimate of 7,915 to 11,726 new jobs in the foodservice industry is particularly important as they are a principal source of employment for the structurally unemployed.* Foodservice industry employment today is constituted of 14 percent minorities and 29.1 percent teenagers. With the current minority teenage unemployment rate at 42 percent, this new job market should help alleviate the severe structural unemployment problem in the United States today.

FEDERAL REVENUE GAIN

Federal income taxes paid by eating establishments

The additional business produced in eating establishments by the employee meal system will increase profits and create additional Federal income taxes paid by eating establishments.

Gross Profits on Incremental Sales: 20.0%

(Source: National Restaurant Association—Table Service Operations—Report 77, prepared by Laventhol and Horwath).

Average Marginal Federal Income Taxes Paid: 30.0% of profit. Based on average taxable profit per restaurant of $65,729 in 1980 (Source: Restaurant Industry Operations—Report 81, prepared by Laventhol and Horwath) and present law corporate tax rates of 30 percent on taxable income between $50,000 and $75,000.

Additional Federal income taxes paid by eating establishments

	Thousands
Value employee meals per year	$339,105
Total additional business produced in eating establishments (85%)	288,239
Gross profit on incremental sales (20%)	57,648
Federal income taxes gained (30%)	17,294

Federal income taxes paid by new employees of eating establishments

Wages: Average wages of restaurant employees are $8,160 in 1982 or $10,414 in 1987 (5th year of operation) assuming a 5% annual inflation factor.

Tips: Estimated to occur on 23.4% of eating occasions with an average tip of 8.0% or 1.9% of new business.

Income of new employees represents:

Wages: 28.6% of new business produced.

Tips: 1.9% of new business produced.

Total: 30.5% of new business produced.

Based on 1981 Bureau of Labor Statistics median earnings for wage and salary workers of $15,900 adjusted for inflation to $21,308 in 1987 and the rates of taxes payable by single taxpayers and married taxpayers effective July 1, 1983, assuming all take the standard deduction:

Average restaurant employee wage—$10,414 (1987 dollars).

Median earnings for wage and salary workers—$21,308.

Average tip of new restaurant employees—1.9% × 288.2 million/7,915 = $692.

Average wage + average tip of new employees—$11,106.

Foodservice industry employment is constituted of 31.8% teenagers and 68.2% married men and women (BLS). It is assumed that teenagers have restaurant employment income as only income source and all others have restaurant employment income as second income.

	Teenagers (31.8 percent)	Married men and women (68.2 percent)
Assume	Standard deduction with one exemption	Standard deduction with two exemptions
Income	$11,106	$11,106 + $21,308 = $32,414
Income tax	$1,257	$4,934
Effective rate (percent)	11.3	15.2

Average Effective Rate—(31.8% × 11.3%) + (68.2% × 15.4%) 3.6% + 10.4% = 14.0%.

Income taxes paid by new employees of eating establishments:

Value employee meal per year (000)	**$339,105**
Total new business produced in eating establishments ($339,105 × 85%)	**288,239**
Additional income created ($288,239 × 30.5%)	**87,912**

Additional Federal Income taxes paid by employees of eating establishments ($87,912 × 14.0%)	12,308
Additional FICA and unemployment taxes paid ($87,912 × 20.5%)	18,021
Total Federal revenue gain:	
Eating Establishments	17,294
New Employees of Eating Establishments	12,308
FICA and Unemployment Tax	18,021
Total	47,623

State revenue implications

State tax authorities will realize significant gains in sales taxes and, additionally, savings in unemployment benefits otherwise paid.

State revenue loss

In calculating this revenue estimate, two fundamental assumptions were made so as to correlate assumptions and methodology to that of the Treasury Department and Joint Committee on Taxation.

1. In estimating this revenue loss, it is assumed that the amount contributed by the employer but not deemed income to the employee is in the form of a non-taxable wage.

2. The average employee marginal state income tax rate (based on median income) is assumed to remain constant at 3.5% through 1987. (This tax rate has been estimated from "Effective Rates of State Personal Income Taxes for Selected Adjusted Gross Income Levels, Married Couples with Two Dependents, 1980" Table 50, Advisory Commission on Intergovernmental Relations.)

Average marginal State income tax rate on wages—3.5%.

	Thousands
Value employee meals per year	$339,105
Share paid by employer and not imputed income to employee ($339,105 × 50%)	169,552
Total State revenue loss ($169,552 × 3.5%)	−5,934

STATE REVENUE GAIN

State income taxes paid by eating establishments

The additional business produced in eating establishments by the employee meal will increase profits and create additional state income taxes paid by eating establishments. For purposes of these computations current average tax rates and industry percentages are assumed to remain constant through 1987.

Gross profit on incremental sales: 20.0%. (Source: National Restaurant Association—Table Service Operations, Report 77, prepared by Laventhol & Horwath).

Average marginal state income taxes paid, assumed: 5.4% of profit.

Based on the estimate that state corporate income taxes represent 18.1% of Federal corporate income taxes. (Source: Federal & Local taxes as a percentage of GNP 1948-78-ACIR) and that the average Federal corporate taxes paid by eating establishments is 30.0% of profits.

Additional State income taxes paid by eating establishments

	Thousands
Value employee meals per year	$339,105
Total additional business produced in eating establishments (85%)	288,239
Gross profit on incremental sales (20%)	57,648
State income taxes gained (5.4%)	3,113

State income taxes paid by new employees of eating establishments

Wages: average wages of restaurant employees are $10,414 (1987 dollars)
Tips: estimated at 1.9% of new business
Income of new employees represents:
Salary: 28.6% of new business.
Tips: 1.9% of new business.
Total: 30.5% of new business.

The effective state income tax rate paid by employees of eating establishments is estimated at 1.9%. (Source: "Effective rates of state personal income taxes for selected adjusted gross income levels, married with two dependents, 1977" ACIR- assuming total gross income of $21,400 for family).

	Thousand
Value employee meal per year	$339,105
Total new business produced in eating establishments ($339,105x85%)	288,239
Additional income created ($288,239x30.5%)	87,912
Additional state income taxes paid by employees of eating establishments ($87,912x1.9%)	1,670

State sales tax

No sales tax is presently gained from employees who bring their lunches from home or who skip lunch.

However, consumption of an employee meal in a public eating establishment produces a sales tax. It is assumed that the average sales tax paid is 6.5%, since most of the in-kind meals will be created in large cities like New York, Chicago, Philadelphia, Washington, Los Angeles, San Francisco, Dallas and Houston where sales tax is higher than average.

In 1987, it is highly probable that average sales tax will be least 1 percentage point higher, but this is not reflected in the computations.

	Thousands
Total value employee meals per year	339,105
Additional business produced for eating establishments ($339,105x85%)	288,239
State sales taxes gained ($288,239x6.5%)	18,736

Unemployment benefits saved

Increased employment in eating establishments will result in savings in unemployment benefits. This is especially significant since eating establishments are major employers of structurally unemployed people—of total restaurant employment, 29.1% are teenagers and 14.0% are minorities.

Unemployment benefits are estimated at an average of 50% of salary earned before becoming unemployed.

It is assumed that only 43.5% of unemployed receive unemployment compensation. (Source: Joint Economic Committee-Economic Indicators January 1982-showing 6,047,000 unemployed with only 2,640,000 insured). The estimated savings do not include welfare payments that may be received by uninsured unemployed.

Unemployment benefits saved = jobs created x salary x 50.0% x 43.5%.

Jobs created: 7,915 (11,726 on the basis of 27 hours per week).

Average salary of employee in eating establishments	10,414
Unemployment benefits saved (thousands) (7,915x10, 414x50.0%x43.5%)	17,928

Total State revenue implications

State revenue loss (thousands)	−5,934
State revenue gain (thousands)	41,447
Eating establishments	3,113
New employees	1,670
State sales tax	18,736
Unemployment benefits saved	17,928
Total State revenue gain (thousands)	$35,513

Cost benefit analysis of employment effects

It is estimated that 7,915 new 40 hour/week jobs will be created in the foodservice industry by 1987. However, in consideration of the average work week in the industry of 27 hours, it is assumed that 11,726 people will be employed to fill those jobs. Based on the revenue estimates calculated above, the per person cost of creating these jobs is:

Static Federal revenue loss (computed on page 3) per person employed ($72,060,000)/11,726	−6,145
Net Federal revenue loss—static Federal loss plus Federal revenue gain (computed on page 6) per person employed ($72,060,000) + $47,623,000/11,726	2,084
Total Federal and state revenue gain—static Federal loss plus Federal revenue gain and state revenue gain (computed on page 9) per person employed ($72,060,000) + $47,623,000 + $35,513,000/11,726	945

Thus using feedback revenue data, there is a savings of $945 per year for each job created in the foodservice industry by this legislation. However, even the static revenue cost of $6,145/per job created compares favorably with the $17,000 cost of each public works job estimated to result from the Highway Revenue Act of 1982 (P.L.

97-424) according to a fact sheet prepared by the Department of Transportation to accompany their original proposals ($5.5 billion revenue loss/320,000 new jobs created = ($17,188)/job). Moreover, this DOT estimate includes both on and offsite jobs plus 150,000 "induced", service-related jobs (i.e. feedback type employment effects) without which the $17,000 per job revenue cost would almost double. By comparison, the employee meal system is a highly cost-effective means of creating jobs in the foodservice industry while conferring benefits on employees of small businesses or branch offices equivalent to those now enjoyed by employees of larger enterprises.

SALES EMPLOYEE MEALS WORLD-WIDE

	Meal System Established	Work Force (000)	1982 Sales Meal p/day (000)	% of Work-Force Receiving Meals	Average Effective Personal Income Tax Rate		Maximum Allowable Deduction Not Treated as Income To Employees
					Income-$10,000*	Income-$20,000**	
United Kingdom	1948	22,900	1,200	5.2%	23.5%	26.8%	$ 0.63 (1)
France	1961/67	24,900	850	3.4	8.8	9.4	2.45 (2)
Belgium	1967	3,900	45	1.2	11.3	22.8	reasonable (no set limit)
Portugal	1974	3,100	90	2.9	17.8	32.2	no limit
West Germany	1975	26,100	105	0.4	12.2	14.4	0.62 (3)
Sweden	1975	4,200	225	5.3	28.8	45.7	2.20
Spain	1975	12,450	4	-	11.2	14.3	no legislation
Italy	1975	21,850	40	0.2	13.4	19.9	no limit
Switzerland	1975	2,700	21	0.8	10.0	13.8	no limit
Netherlands	N/A	4,650	N/A	N/A	9.5	14.4	N/A
S/TOTAL W. EUROPE	-	126,750	2,580	2.0%			
Brazil	1976	31,900	450	1.4%			double deduction
Argentina	1975	8,100	52	0.6			no limit
Mexico	1981	21,400	6	-	---	---	7 times minimum wage/year
S/TOTAL LATIN AMERICA	-	61,400	508	0.8%			
TOTAL W. EUROPE + LATIN AMERICA		188,547	3,088	1.1%			
USA		100,397	401 potential	0.4%	10.5%	12.3%	no deduction away from the employer's premises and if not for the convenience of the employer

* -- rates for single taxpayers assuming standard deduction.

** — rates for married taxpayers, with no children, filing a joint return and assuming standard deduction.

(1) -- the maximum allowable amount has not been changed since 1948.

(2) — this reflects the increase in maximum allowable amount which took effect in January 1979.

(3) -- this maximum allowable amount correlates exactly to that allowable for the company cafeteria.

Chairman **Stark**. The Chair would also—were you here for the Treasury's testimony?

Mr. **Bennett**. Yes, I was.

Chairman **Stark**. If you would speak to that and their objections, that would be informative, I think.

Mr. **Bennett**. I will be happy to.

I have been asked to advise the subcommittee of two endorsements. The National Restaurant Association, which, of course, is the organization whose membership includes virtually all major food service establishments throughout the United States, endorses this legislation and intends to file a statement to that effect with the subcommittee. Likewise, I have also been asked by the Hotel Employees and Restaurant Employees International Union of the AFL-CIO to advise the subcommittee that they also endorse the legislation and likewise will be filing a statement with the subcommittee prior to the cutoff date.

I think the reasons for this joint labor and management support will become clear. Briefly, this bill would amend section 119 of the code by eliminating the requirements of present law that employer-provided meals must be furnished on the business premises in order for the value of the meals to be excluded from the employee's compensation for tax purposes. In an effort to provide parity between employers who are economically unable to or don't have the space available within their workplace to establish a company cafeteria, this concept is being advanced in this country. It parallels almost precisely the concept which has existed in Western Europe for well over 20 years; in Great Britain, it is closer to 40 years.

What the legislation would do is simply remove the requirement in code section 119 that the meal must be provided on the business premises. All other requirements of the law and all requirements within the current regulations relating to section 119, would remain the same—to include the requirement, as Treasury indicated in their written statement, that the meals must be provided for a substantial noncompensatory business reason. We are simply seeking parity between employers who cannot provide company cafeterias and those who can.

This is not, as was also suggested by Treasury, a new fringe benefit. This is a balancing of the availability of an existing fringe benefit. The tests for business purposes would remain the same as I mentioned.

The legislation would impose additional restrictions on the furnishing of off-premises meals. They would have to be applied nondiscriminatorily and be made available to all employees within the employer's workplace. A maximum of one meal per day could be provided, it must be provided during the workday, and only during the normal employee meal periods.

The exclusion would be limited only to meals provided in kind. By that I mean, of course, that no cash could be used. It would not be used for purchase of alcohol or tobacco, and the benefit would not be transferrable to anyone else. We think this would end the discrimination in present law against those employers who cannot physically or economically provide on-premise eating facilities.

I would like to refer to two pieces of testimony which were delivered before your subcommittee, Mr. Chairman, when it and Mr.

Pickle's subcommittee held hearings on fringe benefits just a couple of weeks ago. Mr. Frank Swain, Chief Counsel for Advocacy of the Small Business Administration, said and I quote:

"A small business' ability to offer a worker a package of compensation, including wages and benefits, enables it to compete with larger firms for the most qualified employees. Given two firms offering a prospective employee an equal wage but unequal benefit plans, it is difficult to imagine a worker selecting the job with the less attractive benefit option. The ability of a small business to attract and maintain a quality work force enables it to effectively compete in the marketplace with larger enterprises in the production of goods and services."

Likewise, during the course of those same hearings, Mr. Pearlman, Acting Assistant Secretary of Treasury for Tax Policy, mentioned the concern of the Treasury—and I believe of the Congress—that "tax benefits derived from existing statutory fringe benefits are not fairly distributed among taxpayers." This is an effort to provide that fair and equitable distribution.

The way this system could work—and I will be brief; I know the red light is on here—is that an employer——

Chairman **Stark**. You should have taken it out of Mr. Taylor's time.

Mr. **Bennett**. OK, Mr. Chairman. You won't mind if I take an extra minute.

A group of small employers could approach this concept by getting together and providing a cafeteria near their premises in which a number of them could share. It would be technically off the business premises of the small employers, but this would allow them to provide this benefit to their employees, again for all the reasons that are in the current law.

Another approach would be to utilize nearby eating establishments, perhaps two or three of them that might be in the immediate vicinity, either by direct arrangement between the employer and the restauranteur or through the use of a coupon system such as exists very widely in Western Europe. Let me stress again that this is not a new benefit created for small businesses. It simply removes the present bias and balances the law to allow small businesses to provide employee meals on an equal footing with large businesses that can do so right now.

Turning for a moment, I would like to enter into the record the economic analysis we have done predicated on 1982 revenue estimates which Mr. Duncan requested at that time, and received from the Joint Tax Committee. We have paralleled the methodology used by the Joint Committee Revenue Estimators in an effort to demonstrate feedback revenue and feedback employment effects which we feel confident are inseparable from and proportionate to any static revenue loss from this legislation. Rather than a revenue loss, there would actually be neutrality of revenue; and there would be a revenue gain associated with it when State taxes are also considered.

Rather than go through those calculations and describe them in detail, I prefer to enter that analysis into the record. Again, I indicate that it is predicated on the revenue estimates provided Mr. Duncan in 1982, which are different from those which Treasury advised us only yesterday afternoon they would be providing to you this morning.

In the interest of time, I will stop my testimony here. I will answer any questions you may have, and allow Mr. Taylor to proceed.

[The prepared statement follows:]

Statement of Douglas P. Bennett, Powell, Goldstein, Frazer & Murphy

SUMMARY

1. H.R. 907 would correct a current inequity in the income tax code by providing a means whereby small and medium sized employers could offer meals to their employees during the work day as they are unable to make the investment of capital and provide the space necessary for a company cafeteria.

2. When feedback revenue effects are considered, the $72 million static revenue loss after five years computed to result from enactment of H.R. 907 by the Treasury Department and Joint Tax Committee revenue estimators becomes an $11 million revenue gain.

3. In addition, the employee meal system will enhance employment in the restaurant industry which is a significant employer of the hardcore unemployed, including teenagers, minorities and women.

4. Using the typical restaurant industry work week of 27 hours, approximately 12,000 jobs would be created in the restaurant industry after five years from enactment of H.R. 907, each job costing approximately $6,000 using static revenue estimates, and earning approximately $1,000 in additional revenue using feedback revenue estimates.

5. H.R. 907 is endorsed by both the National Restaurant Association and the Hotel and Restaurant Employees and Bartenders International Union, AFL-CIO, giving it an unusual labor/management backing which reflects the unique benefits to both the restaurant industry and its workforce.

STATEMENT

Mr. Chairman and members of the Subcommittee, my name is Douglas P. Bennett and I am a member of the law firm of Powell, Goldstein, Frazer & Murphy in Washington, D.C. I have been involved in developing and advocating the legislation before you now as H.R. 907 since its inception several years ago. In this connection, I have calculated the economic effects of this legislation within the restaurant and food service industries and on national revenues and employment.

I have been asked to advise the Subcommittee that the National Restaurant Association, which represents all facets of the food service industry, endorses this legislation and intends to file a statement to this effect with the Subcommittee. I have also been asked to advise the Subcommittee that the Hotel and Restaurant Employees and Bartenders International Union, AFL-CIO also endorses this legislation and also intends to file a statement to that effect. The reasons for this unusual labor/management support will become clear from my discussion of the economic effects which demonstrate unique benefits to both the restaurant industry and the restaurant workers from the employee meal concept.

Briefly, as you know, H.R. 907 would eliminate the requirement of present law that employer-provided meals must be furnished on the business premises in order for the value of those meals to be excluded from the employee's compensation for tax purposes. Employers who now have, or who could economically provide, on-premises facilities could not take advantage of this legislation. All other requirements for the exclusion of the value of employee meals under present law would be retained.

Further, the legislation would impose additional restrictions for off-premises meals to be excludable from income. The meals would have to be made available on a non-discriminatory basis to all employees at the same business premises. A maximum of one meal per working day would be permitted. Meal consumption could occur only during normal employee meal periods. The exclusion would be limited to meals provided in kind (that is, no cash could be provided to an employee either directly or as change) and would not include the cost of any alcohol or tobacco purchased by the employee. Finally, this benefit would not be transferable to anyone other than the designated employee. Adequate safeguards would be mandated under regulations to ensure compliance with these conditions.

Present law clearly discriminates against those employers who cannot physically or economically provide on-premises eating facilities, thereby affording larger scale employers a competitive advantage in terms of employee productivity, health and safety. Just three weeks ago on September 18, 1984, Frank S. Swain, Chief Counsel for Advocacy of the United States Small Business Administration testified before this Subcommittee on the obvious importance of employee benefits to small businesses:

"A small business's ability to offer a worker a package of compensation, including wages and benefits, enables it to compete with larger firms for the most qualified employees. Given two firms offering a prospective employee an equal wage but unequal benefit plans, it is difficult to imagine a worker selecting the job with the less attractive benefit option. The ability of a small business to attract and maintain a quality workforce enables it to effectively compete in the market place with larger enterprises in the production of goods and services."

H.R. 907 will correct one current inequity by permitting a small employer either to (1) share a cafeteria with other employers achieving economies of scale not available to each individual business or (2) to provide for employee dining in nearby restaurants either by direct arrangement or through the use of a coupon voucher system. It should be noted that this is not a new benefit created for small businesses. Rather, it removes present law bias and balances the law by enabling small businesses to provide employee meals in an equal footing with large businesses which are currently able to do so.

Further, any of the permissible employer meal plans would encourage employees to dine nutritiously in nearby locations frequented by their colleagues. The obvious productivity gains from such a system have been demonstrated in the countries of Western Europe and Latin America which have adopted this system. Thus, this legislation simultaneously corrects an inequity in the tax law, enhances employee health, safety and productivity and, as discussed below, substantially enhances employment and profitability within the restaurant industry.

Revenue estimates prepared by the staffs of the Treasury Department and the Joint Committee on Taxation in November, 1982, show a $72 million annual static revenue loss after five years (when it is assumed that the employee meal system will be fully implemented). This estimate is based in the assumptions that, after five years, .4 percent of the then-total United States workforce (estimated at approximately 110 million) would participate in the employee meal system and that the average cost of an employee meal would be $3.36 after application of a five percent annual inflation factor over the five year period, which cost would be shared equally by the employer and employee. The estimate also assumes 230 meals for employee year.

Using these same assumptions, and methodology consistent with that employed by your staffs, I have computed the feedback economic effects which follow inevitably from the enactment of this legislation. These include the additional revenues which will be earned by food service establishments and the consequent additional food service personnel who will be necessary to handle this new business. In addition, I have computed the revenue gains at the federal and state levels which will result from the additional income, payroll and sales taxes to be paid by food service establishments because of this new business and also from the additional personal income taxes to be paid by the new employees. Finally, I have computed the savings in unemployment benefits attributable to the additional employment. I would like to enter our complete economic analysis into the hearing record, and I request the Subcommittee's agreement to do so.

Although the Congress has shown a prudent reluctance to legislate based on hypothetical feedback effects, the effects which I have just enumerated are inseparable from the federal revenue loss estimates. The very dollars of federal revenue loss which have been attributed to the passage of this legislation are necessarily translated into dollars spent by employers for employee meals which result in revenue increases for the food service industry. The cited employment effects are the logical consequence of these revenue figures and are consistent with the experience of the countries of Western Europe and Latin America which have all used the employee meal system successfully.

Specifically, using the staff assumption that, after five years, the average value of the employee meal is $3.36, and assuming that 0.4 percent of the U.S. work force (estimated to be 109,700,000) participate, the total value of all employee meals per year would be $339 million. Of that $339 million, 65 percent is assumed to represent new business for eating establishments. This figure is conservative when compared to experience in onr European city where 77 percent of the amount spent for employee meals after enactment of similar legislation represented new business. It is further assumed that an employee will spend an additional 20 percent in his meal in excess of the employee meal plan allowance. Once again this is a conservative figure since participants spend an additional 25 percent in Great Britain and an additional 25 to 70 percent in France. Accordingly, assuming 65 percent new business and 20 percent additional cash, the new revenues created for the restaurant industry would be approximately $288 million (85 percent of $339 million).

In statistics supplied by the National Restaurant Association, the average restaurant's gross profit margin on incremental sales revenue would be approximately 20 percent for a total of $57.6 million in additional income, and the federal income tax revenues generated therefrom at a 30 percent rate would be $17.3 million. Again based on statistics supplied by the National Restaurant Association, approximately 28.6 percent of gross sales revenues is spent on payroll in the average restaurant. Taking 28.6 percent of $288 million and dividing by the most recent average wage of a restaurant employee for a 40-hour work week increased by a five percent inflation factor ($10,414), this addition business would require 7,900 new 40-hour employees in the restaurant industry. However, since the average restaurant worker works only 27 hours a week, the actual result would be 11,700 new jobs.

Similar methodology was used to calculate the estimated federal income and payroll tax revenues to be generated by this increase in employment, respectively $12.3 million and $18 million for a total federal feedback revenue gain of $47.6 million. Further, taking into account both the state income and sales tax revenues generated by this increase in business and in employment (net of state income tax revenues lost on the value of the employer-provided meal) and the savings generated by the corresponding decrease in unemployment claims, the total state feedback revenue would equal approximately $35 million per year.

Thus, overall, the employee meal system would generate annual net revenue gains of more than $11 million per year after five years. Put more simply and precisely, each new employee would generate $945 of *additional revenue* per year!

National Restaurants Association statistics demonstrate that the restaurant industry is a major employer of minorities, teenagers and women, traditionally disadvantaged groups in the job market. Based on current statistics, the restaurant industry work force consists of 14 percent minorities and 29.1 percent teenagers. Thus, an increase in employment in this industry would contribute to a lessening of nationwide structural unemployment.

In comparison to other job creation programs, the revenue gains achieved by this legislation are unique. Even using the static revenue estimates prepared by the Treasury and the Joint Tax Committee staffs, the cost of one food service industry job created by this legislation is $6,145. A public works job created by the proposed Highway Revenue Act of 1982 would have cost over $17,000 if both on and off-site jobs (i.e., feedback employment effects) were considered. Without feedback effects (which were not counted in my analysis of the employee meal system), the $17,000 figure would almost double.

Feedback employment effects are equally likely to result from the enactment of H.R. 907. It is the experience of the National Restaurant Association that each new food service industry job requires a second job to produce the necessary additional food and supplies. However, because these "off-site" jobs do not clearly result from the use of the lost revenue estimated to result from this legislation, they have not been treated among its direct effects.

In summation, the employee meal systems removes an inequity in the federal income tax law which discriminates against small and medium sized employers while simultaneously producing positive nationwide revenue and employment effects. Because it is a program which will benefit small businesses, the food service industry and the hardcore unemployed, the case for its enactment is uniquely compelling. I strongly urge you to adopt this legislation.

Chairman STARK. Thank you very much, and we will give Mr. Taylor a chance to catch up here.

STATEMENT OF HUMPHREY TAYLOR, PRESIDENT, LOUIS HARRIS & ASSOCIATES, INC.

Mr. TAYLOR. Thank you, Mr. Chairman.

Chairman STARK. We have your prepared statement, and you may summarize your testimony in any manner you wish. It will appear in the record in its entirety.

Mr. TAYLOR. Thank you, Mr. Chairman.

I am here to speak about my experience as the manager of a small business in England where we, the Harris firm, have provided meal vouchers to our employees for the last 12 years.

Our employees are, of course, our most valuable resource; and our payroll costs account for some 35 percent of all of our costs. Accordingly, the advantages currently obtained by larger firms in this country—firms with a company cafeteria, particularly a subsidized cafeteria—that advantage is a significant obstacle to our attracting and keeping staff.

From 1970 to 1976, I was chief executive of the Harris operation in England. Because the revenue laws there provided an employer's contribution to an employee's meal does not constitute taxable wages, we adopted an employee meal voucher system in 1972. Monthly vouchers are distributed to every Harris employee working in London; and with the exception of perhaps four or five of the senior people, virtually all of these vouchers are used on a daily basis at the modestly priced restaurants and sandwich shops nearby. I have no doubt that the use by our firm of the employee meal voucher system in London is of real value to us and our British employees.

Like most businesses of our type and size, we are critically dependent on the loyalty and productivity of our employees, and we devote considerable resources to keeping them and training them. And loss of an employee is always a blow. Use of these meal certificates demonstrates our commitment to our employees. We believe that most businesses comparable to our own in the London area have adopted this system and found that its benefits in terms of loyalty far outweigh its costs.

In the 12 years we have used this system, employee meal vouchers, we have had no problems of any kind in administering the system due to counterfeiting or the attempted transfer or sale of coupons. In fact, our experience has been uniformly positive in that, with the exception of our most senior people, our British employees use these daily, and often lunch together.

It is impossible for me to quantify the benefits we have obtained, but I believe this system has contributed to a decrease in turnover and to improved working relationships among our staff. Furthermore, the administrative costs are virtually zero; indeed they are minimal.

Use of this system in our London office helps us to compete with larger firms. And, on the basis of this experience, I have no doubt that it has helped us in terms of productivity, cost-effectiveness and overall morale. I have no hesitation, accordingly, in recommending enactment of H.R. 907, which would permit us to extend a similar benefit to our United States employees.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF HUMPHREY TAYLOR, PRESIDENT, LOUIS HARRIS & ASSOCIATES, INC.

Mr. Chairman and members of the subcommittee, my name is Humphrey Taylor. I am the president of Louis Harris & Associates in New York City. Louis Harris & Associates is, I suspect, well known to you as political polling firm. What you may not know is that we are a broadly-based survey research firm working in many different fields, and that political polls account for only about 2% of our business.

Before proceeding with my testimony, I would like to stress that I am not here as anybody's hired gun. Nobody is paying me to testify. I am here because I was asked to come and speak about my experiences as the manager of a small business in England, where we have provided meal vouchers to our employees since 1972. I believe this experience is relevant to your discussion of this bill. It is true that I was asked to testify by a supporter of H.R. 907 and that we have, in the past, done a certain amount of business with his organization. However, this organization was never more than a very minor client and we have not conducted any business with them since 1981. I am here as my own man.

As with most labor-intensive small businesses, our employees are our most valuable resource, and our payroll-related costs are our largest fixed cost, and account for some 35% of all our costs. Accordingly, the advantages currently obtained by a larger firm in its ability to provide employee fringe benefits, such as a company cafeteria, is a significant obstacle to businesses such as ours in attracting and keeping staff.

From 1970 to 1976, when I moved to this country, I was chief executive of the Louis Harris & Associates' office in London, England. Our London office currently employs 40 persons at all levels of seniority. Because the revenue laws of Great Britain provide that an employer's contribution to an employee's meal does not constitute taxable wages to the employee, our London office adopted an employee meal voucher system in 1972. Our vouchers have a face value of 30 pence, or approximately $0.40, which amount can be redeemed by the employee toward the cost of his noontime meal. (In buying power this is the equivalent to, perhaps, 70 or 80 cents in American restaurants or sandwich shops.) Monthly vouchers are distributed to every Louis Harris & Associates employee working in London, and with the exception of Senior management, virtually all of the vouchers are utilized on a daily basis at modest priced restaurants and sandwich shops close to our offices—which are in the London suburb of Richmond. I understand that virtually all such restaurants accept these vouchers.

Based on my experience with, and observation of, this system in our London office, I believe that adoption of an employee meal voucher system is of significant value to Louis Harris & Associates and its employees. Like most businesses of our type and size, Louis Harris & Associates relies heavily on its employee loyalty and productivity. We devote considerable resources to selecting and training our personnel, and the loss of a trained employee is a blow to our organization. Adoption of the employee meal system enables our London office to demonstrate tangibly our commitment to our employees, and helps to reinforce our recognition of the value of their skills, loyalty, and hard work. Further, because adoption of this system by an employer helps to convey a sense of personal recognition to his employees, most businesses comparable to Louis Harris & Associates in the London area have adopted this system and found that its benefits in terms of staff loyalty far outweigh its rather nominal cost. Speaking personally, I do not know of a single case where an employer has adopted this system and has later discontinued its use—though I assume there must be such cases.

Based on my recent conversation with our London office, I can report to the members of this subcommittee that Louis Harris & Associates has not experienced any problems in administering this system due to the counterfeiting of coupons or to the attempted transfer or sale of the coupons by any of our employees or to any other cause. In fact, our experience over the years has been uniformly positive in that, with the exception of our most senior people, our British employees use these coupons on a daily basis and often lunch together. While it is impossible to quantify the benefits, I believe that this system has contributed to a decrease in employee turnover and to improved working relationships among our staff at all levels of employment.

Institutions of the employee meal system in our London office, therefore, has enabled Louis Harris & Associates to compete with larger firms to attract and retain personnel. Because our employees are our most valuable resource, the ability to offer benefits comparable to those offered by a large employer is of real value to us in a critical aspect of our business. I consider our experience with this system in Britain to have been a definite success in terms of productivity, cost effectiveness, and overall company morale. Accordingly, I have no hesitation in recommending the enactment of H.R. 907, which would permit us to extend a similar benefit to our United States employees.

Mr. Chairman, this concludes my prepared statement. I would be happy to answer any questions that you or other members of your subcommittee may have.

Chairman STARK. Thank you very much.

Mr. Taylor, just out of curiosity, for your skilled workers and lower management types, approximately what is the total reduction of their gross wages in all kinds of taxes—retirement taxes, whatever you might pay for health, and income taxes?

Mr. TAYLOR. I am probably somewhat out of date, as I have lived here for the past 8 years. But my guess is it is probably 10 or 15 percent more than the equivalent deductions which would be paid by our New York office, which of course are higher than in other parts of the country.

Chairman STARK. Is it not the case that for people in positions that would, in this country, say, pay in the area of $30,000 or $40,000 and up, that your marginal tax rates are far higher than ours?

Mr. TAYLOR. No. The marginal tax rate in New York City is 56 percent. In the United Kingdom, it is 60 percent. It was reduced by Mrs. Thatcher from 95 to 60 percent.

Chairman STARK. So you are at 60 with quite a bit lower salaries. Where does that kick in?

Mr. TAYLOR. Substantially lower salaries.

Chairman STARK. And I gather a much more generous fringe benefit—Rolls Royces and Jaguars and drivers and club ownerships?

Mr. TAYLOR. Alas, neither I nor any of my British colleagues aspire to any such glamorous fringe benefits. But certainly company cars are common in the United Kingdom.

Chairman STARK. Yes. Thank you.

Mr. Duncan, do you have some questions?

Mr. DUNCAN. Thank you, Mr. Chairman.

First, may I ask permission that a statement by Mr. Vander Jagt be submitted for the record?

Chairman STARK. Without objection, it will be included.

[The statement is in the appendix.]

Mr. DUNCAN. I have a few questions. Some are mine; some are other members' of the subcommittee who could not be present. I shall adopt them as my own, if I may.

Would this legislation provide additional benefits to any employer, Mr. Bennett?

Mr. BENNETT. It wouldn't be a new benefit per se, Mr. Duncan. As I was explaining—trying to explain in the course of my testimony, present law really has a practical application only to large employers who are able to provide onpremise eating facilities, hence disadvantaging smaller employers.

This would be a balancing or an application of parity to this particular provision of the Internal Revenue Code.

Mr. DUNCAN. We hear a lot about discrimination.

Would employers be permitted to discriminate in favor of highly compensated employees in providing business meals under this proposal?

Mr. BENNETT. No, sir. What we call this concept, the employee meal, is and must be provided on a nondiscriminatory basis. In other words, every employee would have it available to him or her.

Mr. DUNCAN. Why are small businesses disadvantaged under current legislation?

Mr. **Bennett**. As I said, I think the motivations of small businesses respecting their employees would be identical to larger employers. For example, employee health and safety, enhanced productivity, the ability for the employees to discuss business-related matters during the lunch period in a different environment—these motivations would be the same; and yet, small businesses are not now able to provide or offer the opportunity to their employees to participate in such a system.

Mr. **Duncan**. Why should Congress specifically target jobs in the food industry for special legislation?

Mr. **Bennett**. In view of the scarcity of time, I didn't have a chance to get into the economic analysis. The food service industry, we believe would experience potentially very significant increases in sales, which, in turn, would translate into increased employment of a significant nature, I think it is somewhere between 7,000 and 12,000 jobs that we have anticipated would result from this, under the revenue estimates that had been provided to you by the joint committee about a year and a half ago.

These employees principally come from groups which are of the structurally or hard-core unemployed with very high unemployment rates, such as teenagers, minorities and women. They constitute a very high percentage of the food service industry work force.

Mr. **Duncan**. What about competition? Would any part of the food industry be competitively disadvantaged by introduction of the employee meal system, as you propose it?

Mr. **Bennett**. We don't believe so. You basically have two segments. While I am not representing the National Restaurant Association, this is my understanding of the food service industry. You have those businesses which provide food in their own establishments, for example, a restaurant or sandwich shop. The other major segment is one which engages in catering. And it would seem to me, that both segments would benefit directly from this legislation. It would not disadvantage either of them.

In a shared company cafeteria context, there is the likelihood that caterers will be contracted to provide food services. On the other hand, the alternate of eating off the business premises in a nearby eating establishment would naturally benefit that segment of the industry.

Mr. **Duncan**. Thank you, Mr. Bennett.

Thank you, also, Mr. Taylor.

Thank you, Mr. Chairman. I have no further questions.

Chairman **Stark**. Mrs. Kennelly.

Mrs. **Kennelly**. No questions, Mr. Chairman.

Chairman **Stark**. I thank the panel.

Mr. **Bennett**. Thank you, Mr. Chairman.

Mr. **Taylor**. Thank you, Mr. Chairman.

Chairman **Stark**. Mr. Georgine has arrived, so we will call him again.

STATEMENT OF ROBERT A. GEORGINE, PRESIDENT, BUILDING & CONSTRUCTION TRADES DEPARTMENT, AFL-CIO

Mr. **Georgine**. Thank you, Mr. Chairman.

Chairman **Stark**. Welcome to the committee, Bob.

Because of the very long list of witnesses, we have been asking people to limit their remarks to 5 minutes and placing the full testimony in the record in its entirety. And you have been preceded by all friendly witnesses, with the exception of the Treasury, and so you might want to talk to their concerns of enforcing this and give us some idea of why it is unique—their objection to why we should treat the building construction trades employees differently from other taxpayers. And it might be informative for the record if you could particularly point out examples of how or why that is justified.

Mr. GEORGINE. Thank you very much, Mr. Chairman.

I only do have about 4 or 5 minutes of remarks. I have with me—I should introduce—the Honorable Leo Zeferetti and Bob Jones.

I am president of the Building and Construction Trades Department, which represents 15 international unions and, in the aggregate, in excess of 4 million workers.

At the outset, I want to thank you, Mr. Chairman, and express our appreciation first of all for introducing H.R. 700; and second, for giving us the opportunity to present our views.

The department believes the travel expense rules applied by IRS and some courts do not square with the statutory purpose of allowing taxpayers to deduct their ordinary and necessary business expenses. As a result, construction workers are denied deductions routinely allowed to other taxpayers. This is unjustifiable discrimination and has to be remedied.

Let's take a look at a typical construction worker's story. In 1970, Mr. Louis Frederick, a carpenter, lived in Belcourt, ND, with his wife and five children. He had practiced his trade in the Belcourt area for more than 18 years. In the summer of 1970, however, there was no carpentry work available in the Belcourt area. Mr. Frederick's union referred him to an antiballistic missile project in Nekoma, ND, 81 miles from his home. His only alternative to working in Nekoma would have been to go on welfare.

When he took the job, Mr. Frederick knew that his prospects were highly uncertain. Work at the project was seasonal because of the harsh North Dakota winters and layoffs were routine.

That project, like many large construction sites, was located in an isolated area for national security reasons. There was no housing available near Nekoma. Mr. Frederick tried to find a room there, but none was available. On several occasions, he had to sleep in his car. In these circumstances, Mr. Frederick was required to drive back and forth 162 miles each day. He had absolutely no choice.

Mr. Frederick deducted the costs he incurred in driving to the project each day as ordinary and necessary business expenses. The IRS disallowed the deductions on the theory that Mr. Frederick's travel costs were personal expenditures indistinguishable from the commuting expenses of a typical suburban worker. The U.S. Court of Appeals for the Eighth Circuit rejected the IRS position and held the expenses to be fully deductible.

Although Mr. Frederick finally prevailed, he was forced to incur substantial legal expenses to do so. The IRS has officially announced that it will refuse to follow this decision and has aggressively gone after construction workers who, like Mr. Frederick, incurr travel expenses not because they choose to for reasons of personal convenience, but because they have to in order to practice their trades.

Contrary to the IRS view, construction workers are not your typical suburban commuters. Generally, a construction worker lives in the area where he works, but occasionally due to the nature of the construction industry, workers cannot find jobs in their home area. In those cases, they must accept employment at a distant job, often located in remote areas for environmental or national security reasons, or they must remain unemployed.

The worker almost never has any assurance that he will be employed at the distant job for any length of time, or that other work will later be available at that site. He may be laid off because of weather conditions, supply interruptions, or for any other reason; or work near his home may become available once again, which he will take in order to avoid the need to travel.

The Internal Revenue Code authorizes taxpayers to deduct ordinary and necessary business expenses, including travel expenses. The IRS position is that construction worker travel is the result of personal choice, if there is any uncertainty as to the length of the job. That position stands the correct test on its head. It is the uncertainty of the length of the job at the distant site that supports deductibility, because the worker has no choice but to incur the costs if he is to practice his trade. He can't move his family closer to the job to avoid the expense.

In recent months, the problem has gotten worse. The IRS has increasingly asserted new and restrictive positions against construction workers. These new positions, explained in detail in the department's written submission, cannot be justified. In court, however, any IRS determination on the deductibility of travel expenses is presumed to be correct. The costs and complexities of litigation make it difficult for anyone to assemble and present to a court the legal and factual showings to overcome this presumption.

Some workers have nevertheless been successful. But many more have not. Others have given in on audit because they could not afford the cost of fighting.

In addition, there are other substantial reasons supporting a legislative resolution to this problem. The current IRS rules discourage workers from accepting employment at distant projects. They tend to restrict employment in an important sector of the economy, and they reduce respect for the tax system among construction workers and their families.

H.R. 700 provides an easily administrable set of rules to govern the deduction of construction workers' travel expenses. It may not provide relief in every appropriate case, but it does achieve rough justice in the majority of cases. For that reason, the department strongly supports the bill and urges its prompt passage.

In my years as president of the Building and Construction Trades Department, with all of the economic problems faced by the construction industry, I can honestly say that the travel expense issue and the workers' sense of unfair IRS treatment has been responsible for the largest number of complaints and protests I have received from our members. It is time to solve this problem once and for all in an equitable manner.

I thank the committee for giving me the opportunity to testify today, and I would be happy to answer any questions you might have.

[The prepared statement follows:]

STATEMENT OF ROBERT A. GEORGINE, PRESIDENT, BUILDING & CONSTRUCTION TRADES DEPARTMENT, AFL-CIO

DEDUCTIBILITY OF CONSTRUCTION WORKERS' TRAVEL EXPENSES

Mr. Chairman and distinguished members of the Committee: My name is Robert A. Georgine, and I am the President of the Building and Construction Trades Department of the AFL-CIO. The Department was formed and has functioned for the purpose of protecting the interests of the construction workers who belong to its affiliated unions. The crafts and trades represented by those unions include carpenters, bricklayers, boilermakers, plumbers and pipefitters, metalworkers, electricians, laborers, and others. At the present time, over four million workers belong to unions that are affiliates of the Department.

This written statement is submitted in support of H.R. 700, a bill that would clarify the rules on the deductibility of travel expenses of construction workers. The position of the Department is that, in the case of construction workers, the rules currently being applied by the IRS and some courts fail to effectuate the statutory policy of allowing deductions for ordinary and necessary business expenses. As a result, construction workers are subjected to unjustifiable discrimination because they are denied the right to claim deductions routinely allowed to taxpayers in other professions who are in similar circumstances.

This discrimination must be remedied as a matter of simple equity and fairness. Beyond that, however, prompt remedial action is necessary because the rules currently being applied by IRS discourage workers from accepting employment at distant construction projects (many of which are located in remote areas for environmental or national security reasons); those rules as applied also reduce respect for the tax system among construction workers and their families. No policy considerations justify these results.

The following is a brief summary of the points that will be made in this written statement:

The issue of the proper treatment of construction workers' travel expenses is not one that can be resolved in the abstract. Instead, the facts of the actual cases must be examined. That type of examination, we submit, will make clear one overriding fact about these cases: construction workers do not incur travel expenses because they choose to for reasons of personal convenience. Rather, the workers travel substantial distances because they must do so in order to practice their trades.

In the typical case the construction worker practices his trade in the area near his home, and thus he avoids any need to incur travel expenses. But, owing to the nature of the construction industry, there will be times when work is not available in his home area. If he wants to continue to practice his trade at those times, the construction worker must travel to a more distant job. This may require him to get up at 4:00 or 5:00 in the morning, drive 40-50-60 or more miles to work, spend all day at physically demanding labor, and then drive the same distance home each night. Or, it might require him to live in a trailer away from his family for substantial periods of time. The option of moving himself and his family closer to the job is simply not available in most cases. There is rarely housing available closer to the job. Moreover, the worker almost never will have any assurance that he will be employed at the distant job for any length of time or that other work will later be available at that distant site. He may be laid off at any time—because of weather conditions, supply interruptions, or for any other reason—or work near his home may become available once again, which he will take in order to avoid the need to travel.

The revelant provisions of the Code authorize taxpayers to deduct their ordinary and necessary business expenses, including travel expenses. The only restrictions on the deductibility of travel expenses are that they must not be the result of personal convenience or choice (i.e. they must be the result of business necessity) and that they be reasonable in amount. The IRS position is that construction worker travel is the result of personal choice, not business necessity unless the worker knows that the job will last only a short period of time. Any uncertainty as to the length of the job will, in the IRS' view, preclude deductibility. That position stands the relevant inquiry on its head—it is the uncertainty of the length of the job at the distant site that supports deductibility.

It used to be that the IRS challenged the deductibility of travel expenses only where the construction worker remained at the distant job for more than a year. Now, however, the IRS has begun to adopt an even more extreme position. In recent Tax Court cases the IRS has taken the position that a construction worker may not deduct his travel costs where he accepts a distant job because there is no work in his home area, and then leaves the distant job three or four months later to take the first work that becomes available in his home area. In other recent cases, the IRS has taken the position (contrary to established precedent) that construction workers are not entitled to deduct their daily travel costs no matter how long the distant job may last.

The IRS positions cannot be justified. The problem is that any IRS determination on the deductibility of travel expenses is presumed to be correct. Some construction workers have been able, with substantial expenditures of time and money, to overcome this presumption—but the IRS has promptly announced it will not follow those decisions. Many more construction workers have given in on audit because they cannot afford the costs of fighting, or they have been unable in litigation to overcome the presumption of correctness that runs in favor of the IRS. The costs and complexities of litigation make it difficult for an average construction worker to assemble and present to a court the required legal and factual showings.

For all of these reasons, a legislative solution is required. H.R. 700 provides an easily administrable set of rules to govern the deduction of construction workers' travel expenses. It may not provide relief in every appropriate case, but it does achieve "rough justice" in the majority of cases, and for that reason the Department strongly supports the bill and urges its prompt passage.

These points will be discussed below in more detail.

A. CASE HISTORIES

As we noted in the summary, the proper resolution of the construction worker travel issue requires an understanding of the factual context in which the cases arise. This can best be achieved by examining several typical case histories of actual construction workers.

Louis Frederick

In 1970, Mr. Louis Frederick [1] (a carpenter) lived in Belcourt, North Dakota (his home town) with his wife and five children. He had practiced his trade in the Belcourt area, close to his home, for more than 18 years.

In the summer of 1970, however, there was no work available for carpenters in the Belcourt area. Mr. Frederick's union referred him to an antiballistic missile project in Nekoma, North Dakota, 81 miles from his home. His only alternative to working in Nekoma would have been to go on welfare.

When he took the job, Mr. Frederick knew that his tenure at Nekoma was highly uncertain. Work at the project was seasonal, owing to the harsh North Dakota winters. Layoffs were routine occurrences because of the 17,000 change orders made on the project. A laid-off worker would be placed at the bottom of the union's referral list, and a subsequent referral would be to the first available job, which might or might not be the Nekoma project. The project was part of the Safeguard antiballistic missile system, whose construction depended on the progress of the SALT talks. Once the missile site was completed no more carpentry work would be available in the Nekoma area.

In order to take the job at Nekoma, Mr. Frederick had only two choices. Either he had to drive 81 miles to and from Nekoma each day, or he had to move closer to the project. Moving closer to the project was not a realistic option. There was no housing available in Nekoma or the surrounding communities. The limited housing in the area had long been taken, and the government and the construction contractor refused to build any new housing because of the uncertainty of the project. Mr. Frederick tried to find a room near the project, but none was available, and on several occasions he had to sleep in his car. Even if he had found a place for his family at Nekoma, he could be laid off at any time, and if he were laid off there would be no other available work in the Nekoma area. In these circumstances, Mr. Frederick made the only reasonable decision: He decided to drive back and forth each day.

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[1] These facts are taken from the case of *Frederick* v. *United States*, 603 F.2d 1292 (8th Cir. 1979).

Mr. Frederick deducted the costs he incurred in driving to the project each day as ordinary and necessary business expenses. The IRS disallowed the deductions, on the theory that Mr. Frederick's travel costs were personal expenditures, indistinguishable (in the IRS' view) from the commuting expenses of typical suburban workers.

Both the United States District Court for North Dakota and the Court of Appeals for the Eighth Circuit rejected the IRS position and held the expenses to be fully deductible. Mr. Frederick thus finally prevailed, although he was forced to incur substantial legal expenses to do so. The IRS has announced, in Revenue Ruling 80-333, 1980-2 C.B. 60, that it will not follow the *Frederick* decision. Instead, the IRS will continue to maintain its position that construction workers like Mr. Frederick incur their travel costs out of personal choice, not business necessity.[2]

Glenn Johnson

In 1977, Glenn Johnson [3] was a member of the Lincoln, Nebraska local of the International Brotherhood of Electrical Workers. He had been a member of this local union since 1963. His family lived in Lincoln, and he attended church, voted, banked, and paid property taxes there.

In 1976, due to economic conditions, there was a shortage of work in the Lincoln area. Mr. Johnson faced the prospect of unemployment. On December 14, 1976, his local union assigned him to a construction site at St. Marys, Kansas, a location outside its jurisdiction. St. Marys is about 175 miles away from Lincoln. While he worked at the St. Marys site, Mr. Johnson lived at a motel ten miles away. He also made twelve round trips to Lincoln (apparently on weekends).

On March 25, 1977, only three months after assigning Mr. Johnson to St. Marys, his local union required him to return to accept a job that had become available in Nebraska City, Nebraska, within its own jurisdiction. Mr. Johnson immediately quit the St. Marys job to take the closer work.

On his income tax returns for 1977 and 1978, Mr. Johnson claimed the costs of travel between Lincoln and St. Marys as deductible travel expenses. Despite the fact that St. Marys job lasted only three months and Mr. Johnson returned to Nebraska as soon as work there became available, the IRS disallowed the expenses because they were "personal." The IRS took the position his decision to leave the St. Marys job was "personal"—even though that decision simply confirmed that the St. Marys job was only a temporary expedient made necessary by a temporary lack of employment in the home area. The United States District Court refused to overturn the IRS' presumptively correct determination. See also *Trzeciak* v. *Commissioner*, 48 T.C.M. 543 (1984), in which the IRS took the same position in a similar case.

B. TYPICAL WORK PATTERN IN THE CONSTRUCTION INDUSTRY

The problems encountered by Mr. Frederic and Mr. Johnson are not unusual in the construction industry. A construction worker typically maintains his home in the general area where work is available, and moves from job to job within that area. Because construction work is erratic and uncertain, however, most workers eventually experience times where no work is available in their home areas. When this happens, the worker must look for a job elsewhere until work opens up nearer home.

Workers forced to look for work elsewhere face a variety of problems of the kind experienced by Mr. Frederick. Frequent and unforeseeable layoffs are the rule rather than the exception. Work stoppages or slowdowns occur without warning as a result of supply interruptions, political pressures, inclement weather conditions, and other factors. And, in any event, the erection of a building or other facility is by its very nature a temporary venture; when the building or facility is finished, no more work on that site will be available. Even on a large project, work for one craft may last only for a short period of time. Because these projects are often located in remote areas, it is likely that no other construction work will be available in the area.

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[2] Many other workers at the Nekoma project had claimed deductions like those claimed by Mr. Frederick. Their deductions were disallowed by the IRS, and most did not pursur the matter. After *Frederick* was affirmed on appeal, the Ways and Means Committee reported favorably on Section 808 of H.R. 4170, the Tax Reform Act of 1984, which would have allowed Nekoma workers to obtain refunds for the disallowance of their travel expenses nonwithstanding the expiration of the statute of limitations. *See* H.R. Report No. 98-432, 98th Cong., 2d Sess., at 1739.

[3] These facts are taken from the case of *Johnson* v. *United States*, 1983-1 U.S.T.C. ¶ 9256 (D. Neb. 1983).

Additionally, many workers maintain business contacts in their home area as their best (if not their only) method of finding future employment. Maintenance of these business contacts by not moving closer to the job is clearly a business-related consideration.

In these circumstances, a construction worker's decision to incur travel expenses rather than to move his residence and family closer to the distant job site is the result of the realities of the construction industry, not personal convenience. No one could reasonably claim that these are "personal" expenses within the ordinary, common-sense meaning of that term. Nothing in the Internal Revenue Code requires a contrary interpretation—the expenses should not be treated as "personal" (nondeductible) for tax purposes.

C. GENERAL RULES FOR DEDUCTIONS OF TRAVEL EXPENSES

Section 162(a) of the Internal Revenue Code of 1954 authorizes taxpayers to deduct the "ordinary and necessary business expenses" that they incur. It is well settled that travel costs, including the costs of traveling each day to a distant jobsite, will qualify as ordinary and necessary business expenses in appropriate cases. *Steinhort* v. *Commissioner*, 335 F.2d 496, 504 (5th Cir. 1964; *Wright* v. *Hartsell*, 305 F.2d 221, 225 (9th Cir. 1962); *Crowther* v. *Commissioner*, 269 F.2d 292, 299 (9th Cir. 1959); *Carlson* v. *Wright*, 181 F. Supp. 568 (E.D. Idaho 1959), supplemented by 5 A.F.T.R. 2d 1195 (E.D. Idaho 1960); see *Fausner* v. *Commissioner*, 413 U.S. 838, 839 (1973).

The deductibility of the cost of traveling to work was first considered in Solicitors' Memorandum 1648, 1 C.B. 101 (1919) declared obsolete by Rev. Rul. 69-31, 1969-1 C.B. 307, which held that "The test [for deductibility] is whether an expense is incurred primarily because of business as the immediate cause inducing the expenditure." 1 C.B. at 102. Applying that test, the Bureau of Internal Revenue (the predecessor of the IRS) held that a salaried employee could not deduct the costs of commuting to his permanent place of employment, on the ground that:

"If [the taxpayer] prefers, *for personal reasons*, to live in a different city from that in which his business or employment is located, any expense incident to so doing is the result of decision based upon personal convenience and preference, and it is not the result of anything undertaken for business purposes and, therefore, is not a business expense." 1 C.B. at 102-03. (Emphasis supplied.)

Travel expenses are thus nondeductible where they are incurred as a result of the taxpayer's personal choice to maintain his home in a particular area at a distance from his job. *See Commissioner* v. *Flowers*, 326 U.S. 465, 473 (1946); *Sanders* v. *Commissioner*, 439 F.2d 296, 297 (9th Cir. 1971). If the travel expenses are not the result of the taxpayer's personal choice, they are deductible, like any other ordinary and necessary business expense. See, e.g., *Hantzis* v. *Commissioner*, 638 F.2d 248 (1st Cir. 1981); *Frederick* v. *United States*, 603 F.2d 1292 (8th Cir. 1979); *Rosenspan* v. *United States*, 438 F.2d 905 (2d Cir. 1971); *Cockrell* v. *Commissioner*, 321 F.2d 504 (8th Cir. 1963). Where the taxpayer could not reasonably have been expected to move his home closer to his place of employment, the travel costs are the result of business necessity and thus are properly deductible. *Wright* v. *Hartsell*, supra, 305 F.2d at 225; *Carlson* v. *Wright*, supra.

The courts often describe this analysis in terms of whether the job was "temporary" (deductible expenses) as opposed to "permanent" or "indefinite" (nondeductible expenses). Whatever the terminology used, however, the ultimate test for deductibility should be whether the costs were incurred for personal reasons or business necessity. *See, e.g., Frederick* v. *United States, supra. Rosenspan* v. *United States, supra*, 438 F.2d at 912; *Wright* v. *Hartsell, supra: Harvey* v. *Commissioner*, 283 F.2d 491, 495–96 (9th Cir. 1960); *Carlson* v. *Wright, supra; Tucker* v. *Commissioner*, 55 T.C. 783, 786 (1971); *Kroll* v. *Commissioner*, 49 T.C. 557, 563–64 (1968). As the Sixth Court of Appeals put it:

"[T]he essential question in each case [is] whether it would be reasonable under the circumstances of an indefinite stay away from one's previous abode and place of employment to expect the taxpayer to move to the location of his new employment." *Markey* v. *Commissioner*, 490 F.2d 1249, 1253 (6th Cir. 1974).

D. IRS APPLICATION OF THE RULES TO CONSTRUCTION WORKERS

In determining whether construction workers may deduct the travel expenses they incur in traveling to and from distant jobsites, the IRS (apparently for reasons of administrative convenience) applies a "hindsight" approach. In auditing a construction worker's tax return, the IRS ordinarily asks only how long the job actually lasted. The fact that the worker could not at any time have predicted that the job would last a substantial additional time is treated by the IRS as of no consequence—even though that is exactly the relevant issue in determining whether the worker could have been expected to move closer to the job.

The hindsight approach is often used in tandem with a rule of thumb known as the "one-year rule." This informal administrative rule, followed in the field by IRS examining agents, provides that a job that lasts more than one year is presumed not to be "temporary"—whether or not the worker could have determined its length in advance—in the absence of special circumstances. If under this rule the job is not "temporary," travel expenses incurred in connection with it are held to be nondeductible.[4]

The IRS frequently explains its reasons for denying these deductions by stating that the construction worker's job is not "temporary," but rather is "indefinite." As explained in Part C above, these terms are often used in judicial decisions as a short-hand way of describing whether the expenses are necessary; if the distant job is temporary, the travel expenses are necessary, but if it may be expected to last indefinitely, the taxpayer should move nearer the job rather than incur the expenses. The IRS incorrectly applies this test in construction worker cases to mean that any uncertainty over the expected length of the job precludes deductibility. This interpretation, however, is inconsistent with the reasons underlying the test; a taxpayer can reasonably be expected to avoid travel expenses by moving closer to the job only if he has some assurance of some minimum length of employment.

The effect of the IRS position is to discriminate against construction workers by disallowing deductions that are allowed without question in the case of typical white collar workers or professionals. For example, if an attorney travels to a distant city to handle a case that may be settled in several weeks but could take substantially longer (even a year or more), he is not expected to move his family to the distant city. His travel expense deductions are not disallowed simply because he does not know how long the case will actually last. Indeed, the uncertainty as to the length of the case is a strong factor supporting deductibility.

The IRS sees no difference between a suburbanite commuting from his home to a secure job downtown and a construction worker driving many miles from his home to a distant job that might end at any time. In fact, however, construction workers are not typical commuters. They incur substantial travel expense only because they must in order to practice their trades.

E. DECIDED CASES

Because the deductibility of travel expenses is a factual question and the factual findings of the IRS are presumed correct in any court proceeding, the courts have adopted a narrow view of their role in these cases. The detailed reasoning behind the IRS rationale is seldom examined closely, with the result that many construction workers summarily lose their court cases and many more simply submit to the Service's arguments at an administrative level.

Once the IRS has proposed a deficiency, even one based on an erroneous view of the realities of the construction industry, the individual worker is faced with the difficult and expensive task of overcoming the IRS' presumption of correctness. The result is the inequitable treatment by IRS of people like Mr. Frederick and Mr. Johnson—and of thousands of other workers in similar situations.

It is appropriate in these circumstances for Congress to examine for itself the facts common to all construction work, and the typical facts of these travel expense cases, and on the basis of these findings to fashion an appropriate set of guidelines. H.R. 700 represents such a set of guidelines. The need for a solution such as H.R. 700 is highlighted by recent developments indicating an even more extreme position by the IRS.

F. RECENT DEVELOPMENTS

In *Paolini* v. *Commissioner*, 43 T.C.M. 513 (1982), the IRS departed from its "historical position" that the expenses of daily travel to and from a temporary job site outside the worker's usual area of employment are deductible. The IRS contended that travel each day between a personal residence and any place where business is done, even if the taxpayer works at the distant job site for only a single day, is "commuting" unless the trip requires sleep or rest, and that expenses incurred in such travel are therefore nondeductible. The Tax Court, in a decision that was contrary to established precedent, accepted the IRS' position. See, e.g., *Scott* v. *Commissioner*, 110 F. Supp. 819 (D. Minn. 1953); *Waters* v. *Commissioner*, 12 T.C. 414 (1949); *Treanor* v. *Commissioner*, 10 T.C.M. 336 (1951) (expenses incurred in travel between a taxpayer's home and a distant temporary jobsite are deductible whether or not sleep or rest is required).

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[4] The IRS recently announced a modification of the "one-year rule" in certain circumstances. In Revenue Ruling 83-32, 1983-1 C.B. 45, the IRS concluded that a job lasting more than one year but less than two years could be regarded as "temporary" for travel expense deduction purposes if a number of factors can be shown to exist. Whether the principles of Revenue ruling 83-82 will in fact make a significant difference in the IRS' audit and litigating positions remains to be seen, but the ruling is inadequate to deal with the substantial problems described in this statement even if given the broadest possible application.

The IRS previously had attempted to adopt the position espoused in *Paolini* in Revenue Ruling 76-453, 1976-2 C.B. 86, but Congress expressly prohibited the agency from implementing the policy. (See Pub. L. 95-427, 92 Stat. 996 (1978), and Pub. L. 96-167, 93 Stat. 1275 (1979).) The congressional prohibition was allowed to expire in 1981, but on the understanding that no similar ruling would issue until Congress had a chance to act. The IRS apparently is nevertheless asserting that very theory in its litigating positions.

Another recent development is the IRS' abandonment of the "one-year rule" in litigating cases. In some recent cases, the IRS has advanced the position that distant jobs lasting only three months were "indefinite" rather than "temporary," and that expenses incurred in traveling to and from such jobs were not deductible. The rationale is that a construction worker who accepts a distant job because work is unavailable in his home area—and who shortly thereafter accepts work closer to home as soon as it becomes available somehow-incurred the travel expenses because of "personal" choice, not business necessity. Notwithstanding the illogic of that position (both on its face and in light of the statutory purpose), the IRS' position has been upheld by at least two courts. See *Johnson* v. *United States*, 1983-1 U.S.T.C. ¶ 9256 (D. Neb. 1983); *Trzeciak* v. *Commissioner*, 48 T.C.M. 543 (1984). But see, e.g., *Williams* v. *United States*, 1983-2 U.S.T.C. ¶ 9552 (E.D. Ark. 1983) (job lasting over two years was temporary); *Measeles* v. *Commissioner*, 45 T.C.M. 735 (1983) (job lasting about one year was temporary).

The IRS' position in these cases make it clear that a legislative solution is required.

G. H.R. 700: THE SOLUTION

H.R. 700 would correct the problems described above by substituting for the administrative standards currently used by the IRS standards more consistent with the purposes of section 162. The bill would apply to workers traveling to jobs located more than thirty miles from their homes. For employment at such job sites, the bill replaces the "one-year rule" with a new rule that would provide for deductibility for periods of employment shorter than two years. This two-year rule is in harmony with the realities of the construction industry, and would eliminate most of the controversies that now arise by covering the vast majority of cases with a single rule. The rule also satisfies the IRS's need for administrative convenience, since it is based on a single easily verifiable fact—the worker's length of employment. (Of course, the normal rules on substantiation would continue to apply to such travel expenses.)

For the relatively small number of cases not covered by the two-year rule, the IRS would be instructed to determine case by case the reasonableness of the worker's decision to incur travel expenses. In making this determination, the first two years of employment would be ignored, and the "hindsight" approach would be specifically disallowed. Instead, the reasonableness of the decision would be assessed by an examination of all relevant facts and circumstances in light of the statutory purpose of distinguishing business from personal expenditures.

The administrative rules that would be established by H.R. 700 are more consistent with existing law than those now used by the Service, and take proper account of the particular difficulties faced by construction workers. These rules would allow the IRS to concentrate its audit resources on issues and taxpayers that genuinely need attention.

In addition, the bill will operate to encourage employment in an important sector of the economy. The current IRS approach, by making it more expensive for construction workers to practice their trade, discourages those workers from taking distant jobs and encourages them to join the welfare rolls.

I thank the Committee for the opportunity to submit this statement and to testify in support of this important piece of legislation.

Chairman STARK. Thank you very much, Bob.

Mr. Duncan.

Mr. **Duncan.** Thank you, Mr. Chairman.

Thank you, Mr. Georgine.

I have been aware of this problem for a number of years, and in fact I have had a number of bills in to correct it. In fact, I have now pending H.R. 98, which was introduced early in this Congress. H.R. 98 would require the IRS to abide by the *Frederick* rule.

I am hopeful that something can come of this early in the next Congress, because I doubt whether we will have time this session. But in the new Congress, I think something will happen because I think we have a lot of sympathy for the poor construction workers.

Thank you.

Mr. **Georgine.** Thank you.

Chairman **Stark.** Thank you very much, Bob.

Mr. **Georgine.** Thank you very much, Mr. Chairman, Mr. Duncan.

Chairman **Stark.** Our next witness is John Tuccillo from the National Council of Savings Institutions.

Mr. Tuccillo, welcome to the committee. We have your testimony?

Mr. **Tuccillo.** We submitted a prepared statement, yes, sir.

Chairman **Stark.** We will submit it for the record in its entirety. And if you would like to summarize your testimony or expand on it or direct comments to other testimony—were you here for the Treasury testimony?

Mr. **Tuccillo.** Yes.

I would like to summarize my testimony, Mr. Chairman.

Chairman **Stark.** Proceed.

STATEMENT OF JOHN TUCCILLO, VICE PRESIDENT AND EXECUTIVE DIRECTOR OF RESEARCH AND ECONOMICS, NATIONAL COUNCIL OF SAVINGS INSTITUTIONS

Mr. **Tuccillo.** Thank you.

I am John Tuccillo, vice president and research director for the National Council of Savings Institutions. I am here to represent the views of the council on H.R. 1343, which was introduced by Congressman Lowry of Washington.

The National Council strongly supports H.R. 1343. The legislation is needed to achieve parity between mutual and stock savings banks for purposes of the bad debt allowance granted by section 593 of the IRS Code. H.R. 1343 would remedy the situation created in 1981 when savings banks which converted to stock were required to meet an 82 percent asset test as opposed to a traditional 72 percent test.

We would also recommend the bill be expanded to include parity for stock and mutual savings banks under section 594 of the code, which relates to the tax treatment of income from insurance activities of savings banks.

The asset test level, as it currently applies to stock savings banks, deprives them of use of the full bad debt allowance; but, more importantly, it serves as a penalty for conversion to stock charter. This last point runs counter to the public policy expressed in the Garn-St Germain Act of 1982 which authorized stock charters. It is certainly not a desirable——

Chairman STARK. Is the penalty there that, on conversion, if there is—there is a 10-point difference, I gather?

Mr. TUCCILLO. Upon conversion——

Chairman STARK. They pay ordinary on the excess; just recompute it?

Mr. TUCCILLO. Yes.

Chairman STARK. What if they distribute, though—if they distribute in conversion; there wouldn't be a problem?

Mr. TUCCILLO. They are still subject to the higher rule upon conversion. In effect, they go from the 72 to 82 percent test for all prospective activities.

Chairman STARK. Thank you.

Mr. TUCCILLO. At the time when savings institutions are recovering from a devastating economic period and facing uncertainty in the future, it is certainly not a desirable result to inhibit the options for acquiring capital that are presented. Rebuilding of capital is not just in the best interest of the institutions involved, but it is equally in the best interests of the FDIC, FSLIC, the Congress, and the public at large.

Finally, the current application of the 82 percent asset test to stock savings banks really makes very little sense. Conversion to stock forms does not produce changes in characteristics and investment powers of a savings bank; it is simply a change in form of ownership.

A second area where the Tax Code creates inequity between mutual savings banks and stock savings banks is section 594, which relates to the tax treatment of the life insurance business of savings banks. Currently, the law allows alternative tax treatment for only mutual savings banks conducting life insurance activities. This is a section of the code which was not updated in the development of stock savings banks' charters and reflects the fact that at the time the exception was passed there were no stock savings banks.

Savings bank life insurance has been offered in Massachusetts since 1908; in New York since 1939; and in Connecticut since 1941. The insurance is consistently rated at or near the top in terms of consumer value by every independent study.

The Tax Code, in section 594, provides a special rule for tax treatment of income from the life insurance business of savings banks. Section 594 uses the term "mutual savings banks" because there were no stock savings banks until the early 1980's. We, therefore, would ask that section 594 be amended to clearly allow equal tax treatment of life insurance income of mutual and stock savings banks.

I appreciate the opportunity to appear before you and present the views of the council. I will be pleased to answer any questions which you have.

[The prepared statement follows:]

STATEMENT OF THE NATIONAL COUNCIL OF SAVINGS INSTITUTIONS

SUMMARY

1. The National Council supports passage of H.R. 1343.

2. Under section 593, savings banks have historically been required to meet a 72% asset test level to qualify for the full percentage-of-income bad debt allowance.

3. Changes made in ERTA in 1981 to make clear that savings banks with stock form of organization qualify for 593 BDA treatment unfairly penalize stock savings banks by requiring them to meet an 82% asset test level.

4. There is no tax policy or organizational reason to treat savings banks which opt for stock form of organization differently for purposes of the BDA than when they were organized as a mutual. In fact, current tax policy runs counter to public policy expressed in the Garn-St Germain Act of 1982, which allowed stock form of ownership to enhance the capital base of savings institutions.

5. Section 594 of the Code, alternative tax for mutual savings banks conducting life insurance business, should be modified to assure parity for stock savings banks.

STATEMENT

Mr. Chairman and members of the Subcommittee, my name is William P. Morrissey, Executive Vice President for Corporation Affairs, The Boston Five Cents Savings Bank. I am here today to present the views of the National Council of Savings Institutions on H.R. 1343, introduced by Congressman Lowry of Washington.

The National Council represents approximately 600 savings institutions having $400 billion in assets. Our membership consists of state and federally chartered savings banks and savings and loan associations. Among these are both stock and mutual savings institutions. A relatively new organization, the Council was formed on November 1, 1983, through consolidation of the National Association of Mutual Savings Banks and the National Savings and Loan League.

The National Council strongly supports H.R. 1343. This legislation is absolutely necessary to achieve parity between mutual and stock savings banks for purposes of the bad debt allowance granted by section 593(b)(2) of the Internal Revenue Code. We would also recommend that the bill be expanded to include parity for stock and mutual savings banks under section 594 of the Code which relates to the tax treatment of income from life insurance activities of savings banks. We will expand on this matter later on in our testimony.

Section 593(b)(2)—Percentage of taxable income bad debt allowance

Savings institutions are allowed to deduct reserves against loan losses under a percentage of taxable income formula contained in section 593(b)(2) of the Internal Revenue Code. Savings banks and savings and loan associations receive the full bad debt deduction of 40 percent if they maintain a percentage of their assets in specified, housing related assets as described in section 7701(a)(19)(C). For savings banks, this investment percentage has historically been 72 percent. For savings and loans, it has been 82 percent.

Until 1981, the Internal Revenue Code contained references only to mutual savings banks in sections 591 and 593, although the statute covered both stock and mutual savings and loan associations. The lack of reference to stock savings banks was simply because there were, until 1980, no such entities. Savings banks were traditionally chartered by the individual states and were of mutual character. In 1980, the first state granted authority for stock savings banks. In 1978 federal charters for savings banks were authorized and federal stock charters were permitted in 1982.

Since the Internal Revenue Code referred only to mutual savings banks in section 591, 593 and 594, an amendment to the Code was adopted during consideration of the 1981 Economic Recovery Tax Act (ERTA) which clarified that stock savings banks qualified for the Percentage of Income Bad Debt Deduction under section 593(b). Unfortunately, the assist test requirement was set at 82 percent—that required of savings and loans, rather than at the traditional 72 percent required of savings banks. It has been suggested to us that this was the "price" extracted by the Treasury Department for its support of extension of section 593 treatment to stock savings banks.

Thus, a mutual savings bank converting from mutual form of ownership to stock form of ownership immediately faces a mandate to increase its "qualified" assets from 72 percent to 82 percent in order to qualify for the full BDA. This effectively denies them the full use of the section 593(b) deduction because they cannot easily change their asset mix to meet a test 10 percentage points above the traditional standard of 72 percent.

Not only does the asset test level as it currently applies to stock savings banks deprive them of use of the full bad debt allowance, it also serves as a penalty for and a discouragement to conversion to stock charter. This runs counter to public policy as expressed in the Garn-St Germain Act of 1982, which authorized stock charters. It is certainly not a desirable result at a time when these institutions are recovering from a devastating economic situation and facing uncertainty in the near future. These institutions need to have all available options to increase their capital base and strengthen their net worth. The rebuilding of capital is not just in the best interest of the savings banks involved. It is equally in the best interest of the FDIC, the Congress, and the public at large.

Finally, the current application of an 82 percent asset test to stock savings banks make no sense. Conversion to stock form does not produce changes in the characteristics and investment powers of a savings bank. It is simply a change in the form of ownership.

Section 594—Tax treatment of life insurance activities of savings banks

A second area where the tax code creates inequities between mutual savings banks and stock savings banks is section 594, which relates to the tax treatment of the life insurance business of savings banks. Currently, the law allows alternative tax treatment for only mutual savings banks conducting life insurance business. This is again a section of the Code that was not updated concurrently with the development of stock savings bank charters.

Certain states in the past have granted to savings banks the authority to operate a life insurance business. These states are Connecticut, Massachusetts and New York. Savings Bank Life Insurance (SBLI) has been offered in Massachusetts since 1908, in New York since 1939, and in Connecticut since 1941. The insurance is consistently rated at or near the top in terms of consumer value every independent study.

This is how Consumer Reports summed up this unique consumer service in a study published in February 1980:

"Special bargains are available to some buyers. Residents of Massachusetts, or people who work there, have an excellent buy available in the form of Savings Bank Life Insurance, sold by savings banks. Savings Banks in New York and Connecticut also offer low-priced life insurance."

We think stock savings banks in these states should be encouraged to continue offering this product.

The tax code, in section 594, provides a special rule for tax treatment of income from the life insurance business of savings banks. The provision allows such income to be taxed under the rules for life insurance companies, as if the life insurance business of the banks were operated as a separate company. Section 594 uses the term mutual savings bank because, as pointed out earlier, there were no stock savings banks until the early 1980's.

In 1981, when the amendment to ERTA relating to stock savings banks was adopted by the Senate, it provided the BDA for stock savings banks and included provisions which granted equal tax treatment for life insurance income of mutual and stock savings banks. It was also the understanding of parties involved that the provision was included in the Conference Agreement on ERTA. The Conference Report on the Economic Recovery Tax Act of 1981 states:

". . . the Senate amendment extends the special rule under which mutual savings banks can compute their tax on life insurance business as if it were a second corporation to stock associations which are regulated as mutual savings banks."

The Conference adopted the Senate amendment.

Unfortunately, questions have arisen about the section 594 application to stock savings banks because the final language failed to strike portions of the section which used the term mutual saving bank.

We, therefore, would ask that section 594 be amended to clearly allow equal tax treatment of life insuarnce income of mutual and stock saving banks.

CONCLUSION

In summary, we strongly urge adoption of the provisions contained in H.R. 1343 and would urge the inclusion of provisions amending Section 594 to assure parity for stock institutions in that area.

While the specific purpose of this hearing is of a narrower focus, I would like to take this opportunity to share with the Subcommittee the Council's recommendation that the asset test be reduced to 72 percent for savings and loan associations. Given the economic realities of today and the increasing similarities in powers of savings banks and savings and loans, we believe such action is necessary and we urge the Subcommittee to give this action its full consideration.

This change would allow the savings and loan industry to modify its asset structure as authorized in the Garn-St Germain Act of 1982 in order to provide a cushion against future downturns in the mortgage market—thus resulting in a stronger industry. Even such limited restructuring of the asset base will take time. It is, therefore, important that the bad debt allowance be used in this transition to build a reserve base that will provide stability and strength for the industry and for the financial system as a whole.

I appreciate the opportunity to appear before you and present the views of the Council. I will be pleased to answer any questions the Subcommittee members may have.

Chairman STARK. Mr. Tuccillo, we just went through this in the life insurance industry. I have a hunch we will be looking at the taxation of banks. Senator Dole has a particularly warm spot over the way banks have been helpful in passing legislation to help us improve compliance. I think he wants to return the favor next year. There are some of us who would like to help him in that endeavor.

But, first of all, what about if we could calculate the economic income of banks, savings and loans, various lending institutions, and put some kind of a minimum tax—either make them all operate on historic loss, economically making more sense, and with a variety of carryback and carryforward provisions—wouldn't do away with this as larger banks, then these banks cross over into various lines of businesses—it seems to me somebody shouldn't save money just because they happen to sell insurance through a structure of a bank. Or should they be penalized because they happen to be an installment loan provider through the format of a finance company?

It seems to me those distances are bleeding away, and we could—we tried to do it in the insurance thing—if there is a need to adjust the net taxable income, we just adjust it and say, OK, as in the case of the insurance companies where you get to deduct 25 percent. We have to equalize the various financial institutions by doing it that way rather than filling the Code with a bunch of deductions which really no longer serve their purpose, unless there are a few savings banks left who just do mortgages and really nothing else.

Would that be acceptable to your association?

Mr. TUCCILLO. I think you raise a number of issues. Let me try and distinguish between short- and long-term issues.

In the short run essentially what we are asking for here is a restoration of equity between savings banks with two different types of charter. As long as the law reads as it is, we feel that all savings banks should be treated as——

Chairman STARK. There is a reason for that, is there not? In the mutual bank, all of the reserves stay to protect the integrity of the assets which guarantee the depositors. In a stock company, they could indeed dividend out some of the money and, therefore, it doesn't have the same public interest as allowing large reserves that a mutual company would have.

Mr. TUCCILLO. The difference in practice is probably not as great as it sounds in theory, because the stock association is subject to the dictates of the market and has to hold a sufficient amount of capital and surplus to convince potential buyers the stock is worthwhile.

To get to your second point, the longer run concerns that you expressed a moment ago, the council doesn't object to that kind of thorough review. About 10 years ago I was coauthor of what at the time was probably the foremost study of taxation of thrift institutions.

One of the problems we encountered in doing this study was the definition of economic income for any kind of financial institution. That is a fairly major problem. You can pick out an aspect of the Tax Code here for savings banks, an aspect there for savings and loans, an aspect there for commercial banks.

But the point is that the taxation of financial institutions has become such a complex weave that to say you can define economic income in this way for these institutions becomes a very complex problem.

The council is not opposed to a comprehensive review. I believe the Treasury representative this morning suggested that the Treasury is in favor of that, as well. We think in the longer run that may serve the interests of all financial institutions as well as public policy purposes.

But we see that as a very much a long run and very much a difficult concern.

Chairman **Stark**. Can you think of any reason why any growing bank or savings and loan, or savings banks, that is growing, and relatively not overcapitalized should pay any Federal income tax?

With all the options and strategies available, it is pretty hard to conceive of any of them paying any anyway.

Mr. **Tuccillo**. It is certainly the case with banks, commercial banks. Again, going back to my earlier studies, we are looking at commercial banks—we were fairly surprised at the degree to which banks can avoid taxes—in the subsequent 10 years the stories have become much more public.

With savings institutions, however, it is a slightly different point of view. The regulatory system is such that with the savings institutions if you are not explicitly allowed a certain power, then it is forbidden to you.

With banks it works the opposite. If you are not specifically forbidden to do something, you are allowed to. So the amount of leeway which savings institutions have is less.

For the most part, savings institutions which are growing and well capitalized have more options to minimize their tax burden than do other types of savings institutions but far less than do commercial banks in a similar or even a worse situation.

Under those circumstances, I think it is pretty hard to avoid paying some taxes for a growing institution. For the majority of the industry, however, which is not growing, it is awfully difficult to do those kinds of maneuvers.

In effect, a lot of the industry doesn't pay taxes simply because we don't have any income. It is a situation which we would certainly like to see remedied much more than the Congress, I am sure. For those with positive income, those savings institutions who are in a normal slow growth situation, it is very hard not to pay taxes.

Chairman **Stark**. Thank you very much.

Mr. TUCCILLO. Thank you.

Chairman STARK. I am pleased to call the next panel. Mr. John Heilman, and Donald Alexander, counsel, for the Disabled American Veterans: Ellen Kay Hatch, national executive director of the American Kidney Fund, and William Lehrfeld, counsel.

They are here to testify on H.R. 1773, a piece of legislation introduced by the distinguished gentleman from Tennessee and the ranking member of our subcommittee, Mr. Duncan.

We have the prepared statements of all of the witnesses. If you would like to proceed to summarize them or expand on them in the order in which your names were called—it would be Mr. Alexander, Mr. Heilman, Ms. Hatch, and Mr. Lehrfeld—proceed.

STATEMENT OF DONALD C. ALEXANDER, COUNSEL, DISABLED AMERICAN VETERANS

Mr. ALEXANDER. Mr. Chairman, I don't propose to read my prepared statement. I do want to comment on what the Treasury had to say. The Treasury takes the position that an exchange of a limited right in a membership list is somehow a commercial activity that has to be taxed—whether the exchange is with another charity that is trying to build up its list of contributors, or with anyone else.

Now, a charity, unless it is a private foundation, has to get money from the public in order to carry on its charitable work. Perhaps the best way for a charity to solicit is through the mails.

Perhaps that is the most effective way, the least intrusive way, and the way that is least competitive with others. And a charitable list, the DAV's list, is not the same as the Tiffany list, Horchow's list, or the list of people trying to sell jojoba beans, for instance.

Now, we find in the Internal Revenue Code that if a charity engages in a trade show, a bingo game, or rents telephone polls, that is not considered to be competitive and not subject to tax But we do find kind of a strange court case that holds that rentals of mailing lists, followed up by exchanges of mailing lists—you don't give up the entire list—somehow is unrelated business income.

A charity has to maintain its mailing list in order to keep up its charitable activities. There is attrition every year.

You lose people, people move, people die, people lose interest in the charity. The only way to maintain your list is to mail to more people.

And the only sensible way to mail to more people is to mail in a way that is best designed to produce a return to the charity because those people are going to be interested in supporting that charity.

Where do you get the names? You get the names through exchanges of limited mailing rights with other charities. That is the best way to get it—if your list is not much larger than someone else's.

If your list is larger, you can maintain your list by giving limited rights to others, renting names to others, and then plowing that money back, and more back, into obtaining additional names.

That is what we are talking about. There is nothing commercial about it.

Why the Treasury is opposed to this I dcn't understand. It is an excellent bill. And I hope it will be adopted.

Chairman STARK. Thank you very much.

[The prepared statement follows:]

STATEMENT OF DONALD C. ALEXANDER, COUNSEL, DISABLED AMERICAN VETERANS

SUMMARY OF TESTIMONY

The DAV supports passage of H.R. 1773. Contrary to recent IRS and judicial determinations, we believe that the rental or exchange of mailing lists is substantially related to the exempt activities of nonprofit organizations, which depend upon maintenance of up-to-date mailing lists to solicit contributions. We believe Congress should therefore provide an exception from the UBTI provisions for mailing list transactions, particularly in view of the increased burdens faced by private nonprofit organizations as a result of cutbacks in federally-funded social programs.

STATEMENT

I am Donald C. Alexander, a partner in the law firm of Morgan, Lewis and Bockius, Washington, D.C. I appreciate the opportunity to testify today on behalf of the Disabled American Veterans in support of H.R. 1773, and I commend Chairman Stark and the sponsors of the bill for their efforts to correct a serious problem facing nonprofit organizations.

Nonprofit organizations are exempt from federal income tax under section 501 of the Internal Revenue Code, thereby enabling these organizations to carry out their educational, charitable, civic and other socially-beneficial functions. However, a nonprofit organization is exempt from tax only with respect to income derived from activities related to the purpose for which the organization was established. Under Code sections 511 through 513, a tax is imposed, at regular corporate rates, on the "unrelated business taxable income" of an exempt organization, meaning income from a trade or business, which, apart from the need to raise money, is not substantially related to the organization's exempt functions. The so-called UBTI provisions were enacted in 1950 to prevent nonprofit organizations from deriving an unfair competitive advantage over taxable organizations engaged in the same trade or business. S. Rep. No. 2375, 81st Cong., 2d Sess. 28-29 (1950).

H.R. 1773 addresses a problem facing nonprofit organizations because of recent IRS and judicial interpretations of the UBTI provisions. IRS has privately ruled on three separate occasions that a nonprofit organization does not derive UBTI from the exchange of a mailing list with another exempt organization. See LTR 8101002, LTR 8127019 and LTR 8128004. However, the Court of Claims held in 1981 that the DAV was subject to UBTI tax on income derived from renting its mailing lists, and in a private letter ruling addressed to the DAV, IRS later held that "the exchange of mailing lists should be treated the same as cash rentals." Thus, nonprofit organizations are faced with UBTI tax on income they receive from renting their mailing lists and IRS has taken the position that exchanges of mailing lists should be treated as taxable transactions as well.

We question whether the UBTI provisions were intended to have this result, and we believe Congress should take the lead in protecting nonprofit organizations from tax on mailing list transactions.

Nonprofit organizations are, of course, heavily dependent on direct solicitation from the public to fulfill their tax-exempt functions, and therefore maintenance of up-to-date mailing lists is critical to the survival of these organizations. As the members of this Subcommittee are probably aware, attrition rapidly takes its toll on any mailing list, in part because of the high mobility of our society, and the direct and indirect costs associated with a mailing are very high. The DAV, which has a significantly larger mailing list than other tax-exempt organizations, containing over 5.5 million names, is now experiencing an annual loss of 15-17% of the names on its list. To ensure that solicitations are properly targeted, and to avoid costly and wasteful undelivered mail, an organization must continually update its mailing list and add new names to replace those lost through attrition.

The DAV, like many nonprofit organizations, accomplishes this "donor list maintenance" through list exchanges, principally with other nonprofit organizations. The DAV also rents it list, again primarily to other tax-exempt organizations. Although such rentals do not directly result in the addition of new names to the list, the funds DAV derives from renting its list defray the cost of acquiring additional names. Thus, where a direct exchange is not feasible (by reason of the DAV's list being much larger than that of another exempt organization) a rental can achieve the same basic goal.

List rentals and exchanges could be viewed as sales of limited rights to the use of the names on the list. However, the DAV does not engage in sales in the sense of parting with all rights to the names, which an organization might do if it were discontinuing its activities.

Testifying on behalf of the Treasury last year on a bill similar to H.R. 1773, then Acting Deputy Assistant Secretary (Tax Policy) William S. McKee argued against the bill on the basis, in part, that sales, rentals and exchanges of mailing lists were common commercial practices and that tax-exempt organizations should be on the same competitive footing as taxable organizations with respect to these activities. I testified then, and I continue to believe, that there is no basis in fact for equating commercial and tax-exempt mailing list activities or for assuming, as Treasury apparently did, that the two are in competition with one another. The Disabled American Veterans simply does not compete with Tiffany's or Horchow's. Thus, the underlying purpose of the UBTI provisions—to prevent nonprofits from exploiting their tax-exempt status to the disadvantage of their taxable competitors—would not be served by subjecting nonprofit organizations to tax on mailing list activities. Rather, such activities should be recognized for what they are: activities substantially related to the exempt functions of nonprofit organizations and therefore exempt from the UBTI provisions.

The recent attempts by IRS and the courts to characterize mailing list activities as an unrelated trade or business of a nonprofit organization come at a particularly bad time. The Administration's commitment to controlling government spending has resulted in a marked reduction in the level of federal participation in the social services arena, increasing the pressure on private nonprofit organizations such as the DAV to continue their important work.

In areas where the government and the private nonprofit sector both provide services, it is estimated on the basis of current budget projections that funding for government programs will have been reduced by over $50 billion by FY 1987, as compared to FY 1980 levels, and the value of federal support to nonprofit organizations will have dropped 22 percent below FY 1980 levels by FY 1986. To compensate for these reductions and permit the maintenance of 1980 levels of activity, private giving to nonprofit organizations will need to grow an estimated 30 percent per year through 1986, taking into account inflation and other factors. Thus, the pressure on private nonprofit organizations to deliver needed services has never been greater and the need for contributions has never been greater. Further burdening nonprofit organizations by imposing tax on mailing list activities is clearly a step in the wrong direction, particularly since the revenue likely to be derived could not offset the ultimate cost to government if these organizations were unable to continue their work.

H.R. 1773 would avoid this by amending the definition of unrelated trade of business to exclude exchanges, rentals and sales of names from donor lists and membership list. The exclusion would apply only in the case of a tax-exempt organization, contributions to which are tax-deductible, and thus would be targeted to those organizations dependent upon donor list maintenance for solicitation purposes. This legislation would permit nonprofit organizations to enter into exchange or rental agreements to generate names, and, in turn, the contributions necessary to continue their vital work. We urge its passage.

Chairman STARK. Mr. Heilman.

STATEMENT OF JOHN F. HEILMAN, DIRECTOR, NATIONAL LEGISLATIVE AFFAIRS, DISABLED AMERICAN VETERANS

Mr. HEILMAN. Yes, Mr. Chairman. Let me say at the outset we do appreciate the fact that you have scheduled H.R. 1773 for this hearing.

I may also say to you, Mr. Duncan, as the primary sponsor of this bill, that our organization does appreciate your advocacy on this issue.

I will summarize my statement, Mr. Chairman.

The DAV is a congressionally chartered, nonprofit veterans service organization. We are exempt under section 501(c)(4) of title 26. Our membership is composed of wartime veterans who have incurred a service-related wound, injury, or disease, during their active military service, and presently our membership is some 580,000 veterans.

Mr. Chairman, the DAV provides a variety of services and programs for all of our Nation's veterans irrespective of their membership or eligibility of membership to the DAV, as well as their family members and survivors.

We provide direct representation before the VA for benefit entitlement, we participate in the Veterans' Administration voluntary service program and provide hundreds of thousands of man hours and voluntary work in hospitals and monetary and material contributions to hospitals.

We administer scholarship programs to children of needy veterans, provide direct monetary relief to veterans who are victims of disasters or in emergency situations.

In a nutshell, our annual programs of service to our membership and to all veterans is currently in excess of $21 million per year. The DAV receives the funds, as Mr. Alexander indicated, through a direct solicitation to the general public.

Our funding effort is entirely in-house. We employ no outside fund raisers. We maintain our own donor list and make annual solicitations from that list.

Currently our donor list is 5.7 million names. The DAV has perhaps one of the largest donor lists of all nonprofits in the country. And we do have an annual attrition rate that impacts on that list, as Mr. Alexander indicated, folks die, they move away with no forwarding address, they cease contributing, they request no longer to be solicited.

Therefore, we purge such names from our list. And that translates to a loss of over 900,000 names per year from the list. Obviously they have to be replaced or in a very short period of time the list would disappear.

We do this through the renting and exchanging of names and addresses to and with other nonprofit organizations primarily, and to a smaller degree with also some commercial entities.

The DAV, by the way, does not sell its names. It was in 1974 that IRS said to us that our rental income from this list maintenance activity was UBTI. We went to court on this issue and in 1981, received an adverse decision from the U.S. Court of Claims.

Also in 1981, through a later ruling, IRS said that the exchange of names, when no money changes hands, is also UBTI.

Mr. Chairman, as we understand it, UBTI was put in the statute books to prevent nonprofit organizations from having an unfair competitive edge over commercial groups who might be engaging in the same type of activity. UBTI statute also says that something will not be considered as taxable income if it is substantially related to the tax exempt purpose for which the organization received its exemption in the first place.

We contend that this court decision and the IRS ruling subverts the intent of Congress. List maintenance activity is very much substantially related to the tax exempt purpose of the DAV—if we were not able to maintain our list, the funds would cease to exist and we would not be able to operate our programs.

We don't engage in this activity to make money, although we do have a rental income—that income is far and away offset each year by the costs involved in terms of our mailing out to the names we receive to identify potential donors.

Finally, I do want to make the point, as Mr. Alexander indicated, nonprofit organizations in this country provide a myriad of services that duplicate or are similar to Federal efforts providing benefits and services to a broad category of beneficiaries, and we think they should be encouraged to continue this type of work and to expand upon their programs.

So we would urge the subcommittee to give favorable consideration to the bill. Thank you.

Chairman STARK. Thank you very much.

[The prepared statement follows:]

STATEMENT OF JOHN F. HEILMAN, NATIONAL LEGISLATIVE DIRECTOR, DISABLED AMERICAN VETERANS

SUMMARY

The principle source of revenue for the Disabled American Veterans (DAV) is achieved through direct solicitations to the general public. Currently, the DAV's donor list suffers from an attrition rate (loss of names) of approximately 15%-17% per year (prior to 1984, the annual rate of attrition was 12%). Donor list maintenance is achieved by the DAV through the renting and exchanging of manes from its donor list to and with other groups and organizations, primarily nonprofit groups.

By virtue of an IRS ruling and Court of Claims decision, it has been determined that the list rental income of DAV is Unrelated Business Taxable Income (UBTI) and therefore subject to taxation. IRS, through a later ruling, has also expanded this decision to encompass DAV list exchange activity and also render it subject to UBTI.

The DAV believes these decisions subvert the original intent of Congress with regard to the UBTI statute. We believe the Congress intended this statute to prevent tax exempt organization from conducting business operations with an unfair competitive edge over taxable businesses engaged in similar activity.

The DAV maintains:

1. The exchanging and renting of donor names by nonprofit groups is not competitive with the private sector (this point was conceded in the Court of Claims decision);
2. List rental/exchange activity (donor list maintenance) is very much related to the purposes which constitute the basis for the tax exempt status of nonprofit organizations; and
3. The charitable programs of nonprofit groups fill a vital need for many categories of deserving and needy Americans. In may cases, they supplement and/or take the place of similar local, state and federal efforts. Promotion and support of these charitable efforts and the value derived from them far outweigh the relatively modest impact of H.R. 1773 on federal revenues.

STATEMENT

Mr. Chairman and Members of the Subcommittee, on behalf of the entire national membership of the Disabled American Veterans, may I say that we deeply appreciate the opportunity to present our views on H.R. 1773, a measure introduced in the House by Representative John Duncan and cosponsored by Representative Frank Guarini, which proposes to amend the Internal Revenue Code of 1954 with respect to the Unrelated Business Taxable Income of certain nonprofit charitable organizations.

Mr. Chairman, the Disabled American Veterans supports Congressional passage of H.R. 1773, which Representatives Duncan and Guarini were so kind to introduce at our request. In addition to Representatives Duncan and Guarini, 18 members of the full Committee, including seven members of the Subcommittee, are cosponsors of either H.R. 1773 or H.R. 4287 (a bill similar in purpose but narrower in scope).

Before commenting upon the bill itself and stating why we believe it merits favorable action. I believe it is pertinent to provide the Subcommittee with a few words of background information concerning our organization.

Background information on the Disabled American Veterans

The Disabled American Veterans (DAV) was formed by a group of disabled World War I veterans in 1920. It was chartered by Act of Congress on June 17, 1932 and was incorporated in the state of Ohio in 1938. The DAV has been granted an exemption from taxation under Section 501(c)(4) of Title 26, United States Code, as amended, and its principal office is located at 3725 Alexandria Pike, Cold Spring, Kentucky.

The purposes of the DAV, as set forth in its Constitution and By-Laws, are to uphold and maintain the Constitution and laws of the United States; to realize the true American ideals and aims for which those eligible to membership fought; and to advance the interests and work for the betterment of all those who have become wounded, injured and otherwise disabled as a result of wartime military service in our nation's Armed Forces, as well as their dependents and survivors.

Eligibility for membership in the DAV is restricted to veterans of honorable wartime military service who have incurred a service-related wound, injury or disease. At present, the national membership of the DAV is 853,854, with a ladies' Auxiliary of 88,899.

The most important program of the DAV is its National Service Program. This program involves employment of some 249 National Service Officers (NSOs) who are also service-connected disabled veterans. These NSOs are recognized by Congress as "attorneys-in-fact" and, as such, are authorized to represent veterans (both disabled and non-disabled), their dependents and survivors before the Veterans Administration's Rating Boards in determining compensation, pension, hospitalization and other benefit entitlement. This representation is offered free of charge to all veterans, their dependents and survivors as the expenses of the National Service Program—which presently require $21 million per year—are paid for by funds raised by the DAV. The National Service Program has offices located in every Veterans Administration Regional or District Office in the United States and DAV NSOs regularly visit every VA hospital.

In addition, the DAV has a large staff in Washington, D.C. to handle the appeals of veterans, their dependents and survivors who have received adverse benefit determinations by VA agencies of local jurisdiction.

The DAV also maintains other programs which provide services and benefits to its membership and/or the veteran community at large. Among these programs are: a National Employment Program, a National Legislative Program, a fleet of Field Service Units which seek out veterans who do not have access to VA Regional Offices, participation in the Veterans Administration's Volunteer Services Program (VAVS), an Educational Scholarship Program for the children of needy disabled veterans and programs of financial relief for victims of natural disasters and those in need of "emergency" assistance.

SOURCE OF DAV REVENUE

Mr. Chairman, the DAV's primary source of revenue to conduct its tax-exempt operations is realized through an entirely "in-house" administration of direct solicitations to the general public. Contributions to the DAV are deductible pursuant to the provisions of Section 170 of Title 26, USC.

The DAV maintains a "donor list" and conducts annual mailing solicitations from that list (due to increased program costs, in 1983 the DAV commenced three solicitations annually). Public support is broad based in the form of relatively small individual contributions—the average contribution is currently running at slightly under five dollars.

DONOR LIST MAINTENANCE

The size of the DAV donor list in recent years has been in the area of six million names and declining slightly (5.7 million in the Fall of 1984). Periodically, the DAV removes the names of individuals from its list who:

1. Are deceased,
2. Have moved with no forwarding address,
3. Have not responded to recent solicitations, and
4. Have requested not to be solicited.

This donor list "attrition" occurs at the rate of 15-17 percent per year, translating into an annual loss of over 900,000 names from the list. These names have to be replaced. If replacement did not occur, contributions would drop dramatically and program operations would be placed in serious jeopardy. Therefore, donor list maintenance, i.e., name acquisition activity, must be engaged in by the DAV. Name acquisition is the only way to maintain viability of the donor list.

Name acquisition is achieved by the DAV through the rental and exchange of names from its list to and with other groups or organizations. The DAV has been engaged in this list acquisition activity since the early 1960's. The DAV does not sell its names.

As stated, the DAV rents and exchanges names from its donor list primarily to and with other tax-exempt organizations but also, to a limited degree, to and with the private sector. During the last ten years, our rental/exchange activity has been 80%-90% with other 501 organizations and 10%-20% with commercial groups. In 1983, the ratio was 85% to 501 organizations, 15% to commercial organizations.

I wish to underscore, Mr. Chairman, that the DAV solicitation operation is entirely "in-house" and, though we do have the capability of providing complete mailing services to other organizations, to avoid direct competition with commercial mailing organizations, the DAV does not make such mailing services available to any group.

TAX STATUS OF INCOME RECEIVED FROM DONOR LIST RENTAL/EXCHANGE

Mr. Chairman, under present law (Section 511-13, Title 26, USC), organizations such as the DAV, though generally tax-exempt as 501 organizations, are subject to tax with regard to income received from unrelated trade of business activity (UBTI).

Section 513 of the IRS Code defines an unrelated trade or business activity as: ". . . any trade or business the conduct of which *is not substantially related* (aside from the need of such organization for income of funds or the use it makes of the profit derived) to the exercise of performance by such organization or its charitable, educational, or other purposes or function constituting the basis for its exemption under Section 501 . . . (emphasis added).

In 1974, the Internal Revenue Service determined that DAV's income from donor list rental activity is subject to taxation as UBTI. In response to this determination, the DAV initiated legal action asserting, among other things, that its income from list rental activity should not be regarded as UBTI. A decision was rendered on May 20, 1981 unfavorable to the DAV (*Disabled American Veterans* v. *United States* 605F .2d 1178[Ct.Cls.1981]). Furthermore, by means of a 1981 ruling, IRS has expanded this court decision to also encompass DAV's list exchange and likewise render this activity subject to UBTI.

Mr. Chairman, the DAV believes these decisions are not in keeping with the stated intent of Congress when it placed Section 511-13 in the statute books. As we understand it, the unrelated business income tax was imposed to prevent tax-exempt organizations from conducting business operations with an unfair competitive edge over taxable businesses engaged in conducting similar activity in the private sector.

We do not believe that our list rental/exchange activity falls within such a category. We do believe that it is very much related to the performance of the charitable programs which constitute the basis for our 501 exemption.

H.R. 1773

In view of the above, Mr. Chairman, the DAV is seeking Congressional relief from the Court of Claims Decision and IRS Ruling and the pending measure, 1773, would extend that relief.

Briefly, the measure provides that in cases of nonprofit "501" organizations, contributions to which are deductible under Section 170 (of the IRS Code), the term "trade or business" does not include that which consists of exchanging, renting or selling names and addresses of donors to, or members of, such organizations.

I do wish to point out, Mr. Chairman, that such a modification of law would not be precedential in nature. An example of recent, similar Congressional intervention on behalf of charitable organizations is seen in Public Law 95-502 (enacted 10/21/78) where income received through the conducting of "bingo" games by certain non-profit groups was determined not to be in competition with the private sector and therefore not subject ot UBTI.

We would like to point out that should 501 organizations be granted the tax relief sought, the annual decrease in federal tax revenues would be quite small.

Against such a minor revenue impact we ask the Subcommittee to consider the services rendered and benefits offered to vast categories of deserving and needy people by charitable organizations. Some groups—and the DAV is a prime example—actually save our government and the American taxpayer millions of dollars of expenditures through the performance of programs which supplement and/or take place of similar federal efforts.

For example those 249 DAV claims representatives (NSOs) mentioned earlier perform the exact same services as do contact representatives and benefit counselors employed by the Veterans Administration. The VA has informed us that should they be required to enlarge their staff by the same number of DAV NOSs and supportive clerical personnel, an additional direct expenditure of $7.7 million would be required (in the VA budget).

Also, during calendar year 1983, the DAV provided:

1. Almost one half million manhours of voluntary service and over $500,000 in monetary/material contributions to VA hospitals through the VAVS program.
2. Over $530,000 in college scholarship assistance to the children of needy disabled veterans.
3. Over $750,000 in direct monetary assistance to veterans in financially precarious situations.
4. Over $99,000 in direct monetary assistance to veterans who fell victim to "natural disasters."

In summation, Mr. Chairman, the exchanging and renting of donor list names by nonprofit groups is not competitive with the private sector. It is engaged in for a reason substantially related to the charitable works of 501 organizations. And, finally, while exempting such revenue from taxation would have no significant impact on federal revenues, it would encourage the continued existence and expansion of many beneficial programs and services of charitable organizations.

We therefore respectfully urge the Subcommittee to take favorable action on H.R. 1773.

This completes my statement, Mr. Chariman. Again, on behalf of the DAV, I wish to thank you and the members of the Subcommittee for the opportunity to present our view on this most important subject.

Chairman **Stark**. Ms. Hatch.

STATEMENT OF ELLEN KAY HATCH, NATIONAL EXECUTIVE DIRECTOR, AMERICAN KIDNEY FUND

Ms. **Hatch**. Yes, Mr. Chairman. Thank you very much for the opportunity to be here before your committee.

I am not going to give a statement. Mr. Lehrfeld is giving a statement, both for American Kidney Fund and Amvets. I am here to answer any questions should you need them.

I would also like to thank Mr. Duncan for introducing this bill.

Chairman **Stark**. Welcome to the committee, Mr. Lehrfeld.

STATEMENT OF WILLIAM J. LEHRFELD, COUNSEL, AMVETS NATIONAL SERVICE FOUNDATION AND THE AMERICAN KIDNEY FUND

Mr. **Lehrfeld**. Mr. Chairman, thank you.

I would just like to build on what Mr. Alexander said and bring to the attention of the committee some anomalies in the current taxation of exempt organizations.

If either one of you gentleman donated a suit or other item of property to the Amvets thriftshops, we could sell that donated suit to the public tax free. If we took your name and address down and wrote you a thank you letter for that contribution, and kept that name and address in our files, and then sold that name and address, the Government's position is that the name is not donated merchandise and its sale is taxable.

That is a very unique kind of construction of what is an unrelated and related business.

Second, the Government has told us that if an exempt organization sells the natural byproduct of an exempt function, it is not unrelated business income. If you have an agricultural college in California or Tennessee which maintains a dairy herd for the teaching of students, the agricultural college can sell the milk of the dairy herd tax free.

What we are saying in this presentation basically is there is no distinction between the byproduct exemption given colleges when they sell the milk of a dairy herd and the byproduct exemption which you would, in effect, be legislating on here if we turn around and sell a donor's name which is the byproduct of his gift.

Lastly, I don't know that we need to put this card in the record—I have some Christmas cards here—the Internal Revenue Service has told exempt organizations such as the Metropolitan Museum of Art that they can sell the cards tax free.

A revenue ruling they published, and I think it is pertinent—says the fact that the cards are promoted and sold in a clearly commercial manner at a profit and in competition with commercial greeting card publishers does not alter the fact of the activities being related to the museum's exempt purpose.

In ruling 73-104 the Service is saying you can be as commercial as you choose in selling a greeting card, especially during the holidays, and that does not affect whether it is related or unrelated. In turn, they argue here as they did in their attempt last year on S. 825, that anything that smacks of a commercial purpose is per se unrelated.

Perhaps they have some secret knowledge that we are not privy to on how they can discern what is a good commercial purpose for museums and what is a bad commercial purpose for other types of exempt organizations.

But they have yet to share their information with us. These kinds of anomalies creep into IRS judgments and I think it is appropriate that the committee consider the lack of commercial opportunities for organizations to sell our mailing list. As Mr. Alexander and others have noted, nobody else has our mailing list of donors.

Nobody can compete with the exempt organization, because we are the only ones that have the list of the donors. So if we chose to sell it, we are not unfairly competing with anybody else as to this particular product.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF WILLIAM J. LEHRFELD, COUNSEL, AMERICAN KIDNEY FUND, AND AMVETS NATIONAL SERVICE FOUNDATION

A. INTRODUCTION

My name is William J. Lehrfeld of the firm of Lehrfeld & Henzke, Washington, D.C. Our firm represents numerous Sec. 501(c)(3) and Sec. 501(c)(4) organizations which may be affected by this legislation, including the American Kidney Fund and the AMVETS National Service Foundation.

The purpose of this written testimony is to set out, for the record, the position of both these organizations on the amendments proposed to Sec. 513 of the Internal Revenue Code by H.R. 1773. Sec. 513 of the Code contains various special exemptions from the tax for certain revenues derived by exempt organizations from programs which are offered to the general public, members of the organizations, or students, patients, etc. If an exempt organization described in Sec. 501(c) receives (or is deemed to receive) gross income from its exchange, sale or rental of mailing lists of donors or members, the net income may be, or may not be, subject to tax according to the Internal Revenue Service, based upon the specific facts and circumstances.

H.R. 1773 would establish a blanket exemption from tax for list dispositions without regard to the limited exemptions which may exist today.

B. PURPOSE OF AMERICAN KIDNEY FUND

The American Kidney Fund was founded in February of 1971. Its purpose is to provide direct financial assistance to kidney patients for the cost of dialysis and transplantation. Other patient costs are subsidized including transportation to and from the dialysis center, medications, the 20% balance left by medicare for home dialysis supplies, payments for home dialysis machines, not covered by medicare, and temporary financial assistance for living expenses.

Last year AKF assisted about 12% of the end stage renal disease population and our average grant was about $300 though some people may receive as much as $5,000 or $6,000.

AKF receives no governmental financial support; revenues are from contributions by the public (through direct mail) and AKF is a member of the Combined Federal Campaign. AKF mails to its donor list about 6 or 7 times a year; it spends $30,000 or $40,000 a year to buy new names; and it pays about another $30,000 in data processing charges to make our donor "exchangeable" with lists AKF obtains from other charities.

AKF does not now sell or rent its list.

C. PURPOSES OF AMVETS NATIONAL SERVICE FOUNDATION

AMVETS was originally organized under an Act of Congress for the support and benefit of veterans of World War II. Its membership is now open to veterans of Korea and Viet Nam. The basic purposes of the AMVETS are to serve the welfare and assist in the rehabilitation of disabled veterans and to establish facilities for the assistance of all veterans and to represent them in their claims before the Veterans Administration and other governmental organizations without charge; to dedicate its membership to the service and best interests of the community, State and Nation; and to advocate the development and means by which all Americans may become informed citizens and participate fully in the functions of democracy.

AMVETS National Service Foundation is the arm of AMVETS which has the primary responsibility for raising monies from the general public through direct mail appeals for contributions and through its thrift stores. It is tax-exempt under Code Sec. 501(c)(4), and is eligible to receive tax deductible contributions under Sec. 170(c)(3).

D. SUPPORT FOR S. 1773

We appear today because of our concern about the privileges and immunities contained in the Internal Revenue Code relating to charities and veterans' organizations. There is no specific current exemption of income from the sale, rental or exchange of donor names by a nonprofit organization owning such lists. The taxability of such income under current law and administrative rulings is unclear made more so by an actual conflict of views between the Internal Revenue Service and the Treasury Department. We support enactment of H.R. 1773 and its treatment of income derived from the sale, rental or exchange of lists of names and addresses of donors and members.

In 1983, the American Kidney Fund raised over $3 million in contributions from the public using, among other means, direct mail solicitation. In 1983, the AMVETS Foundation raised over $3 million in contributions by soliciting the public and raised another $700,000 from its thrift stores. These contributions are clearly not subject to the unrelated business income tax. Neither organization, as yet, has rented its donor mailing list because of the concern over the Internal Revenue Service's published position contained in Rev. Rul. 72-431, 1972-2 C.B. 281, despite the fact that the sale or rental of such lists would yield additional revenues for their programs.

In order to raise funds to support its activities, AMVETS buys, "mailing lists" composed of thousands of names of potential contributors, of varying characteristics, at various times, for what the market demands. AKF, on the other hand, obtains new names by exchanging its 700,000 or so donor list with other medical-research charities. Both must continue to do so since each house list of current donors gradually wears out and must be constantly replenished. AMVETS also receives some new names and addresses of prospects through exchanges.

Once an individual on a prospect list makes a contribution, the donor's name is then placed on a "house list". Neither organization exchanges its house list with commercial brokers or agent or with non-charitable organizations. The even up exchange of donor names is common in the nonprofit community for groups which rely on direct mail for their contributions and which have similar exempt interests.

We have not treated our exchange of mailing lists as a taxable event for several reasons. Section 1031(a) of the Code exempts from income tax the gain on like-kind exchanges of productive property. Also, we exchange only with charities which are enhancing the by-product of their own exempt function of raising funds, so that such activity comes within the "substantially related" exception in the unrelated business tax regulations on by-product sales. In some transactions, we have treated the exchange transaction as a wash because the value of what we receive from the other charity in the trade equals the actual cash basis of what we give up. Lastly, in any year where we have only one or two exchanges, the discontinuous nature of the transaction makes it an "irregular" business activity—whether or not related.

E. CURRENT ADMINISTRATIVE AND LEGAL INTERPRETATIONS

The administrative position of the Internal Revenue Service is confused. Some private ruling letters take the position that exchanges of mailing lists by publicly supported exempt organizations do not give rise to unrelated business income. (P.L.R. 8101002, 8127019, 8128004.) Another ruling appears to hold the opposite. (P.L.R. 8216009) Contrarily, the Treasury Department has taken the position that even up exchanges among exempt organizations give rise to unrelated business income.[1] This confusion in the private rulings process indicates that the agency hasn't put its house in order on this point of exchanges. Until the Internal Revenue Service publishes a ruling on exchanges, as it did with the commercial sale of membership listings (Rev. Rul. 72-431, 1972-2, C.B. 281), the public cannot safely rely on either the favorable or adverse private rulings due to Sec. 6110(j)(3) of the Code. And public charities are made more uncomfortable by the failure of the Treasury to formally disapprove the favorable rulings by putting its unrelated argument in the context of existing regulations oir published rulings.

Enacting H.R. 1773 will nullify the decision rendered in 1981 by the Court of Claims involving the Disabled American Veterans, 650 F.2d 1178 (1981). Although our solicitations of gifts from the public and current exchanges of donor lists are carried out in a different manner than was involved in the *DAV* case, both organizations are very concerned that the *DAV* case may be construed to create a per se rule that all sales, rentals and exchanges of donor lists by charitable organziations will generate unrelated business taxable income. We believe that not only would this be an overbroad reading of the case,[2] but also that this approach is not justified by a thoughtful construction of the applicable sections of the Internal Revenue Code as originally enacted in 1950 and as extended to veterans' organziations in 1969.

For example, Sec. 513(a)(3) of the Internal Revenue Code states that the term "unrelated trade or business" does not include a trade or business, "which is the selling of merchandise substantially all of which has been received by the organziation as gifts or constributions."

Thus, an exempt organization's income which is derived from the sale of donated merchandise cannot be categorized as an unrelated business income. Revenues are excluded from tax regardless of the unrelated nature of the income producing activity. It is our belief that the individual names and addresses which, when aggregated, compose the AKF and AMVETS' "house lists", could well be regarded as contributions or gifts of merchandise from the individual donors within the meaning of Code Sec. 513(a)(3). See, eg., Gordan, "Right of Property in Name, Personality and History", 55 Northwestern Law Review 553 (1960). As a result, when AKF and AMVETS takes the names and addresses of indiviidual donors and formulates them into a computerized mailing list, such a list could reasonably be deemed "merchandise" under excising law; the sale of a list of names should not generate unrelated business income because of the exception provided by Code Sec. 513(a)(3). Some IRS agents may think that a "name" is not "merchandise" and even if it were, Congress didn't intend to strain the exception for sale of donated goods to such a unique format of gifted property.

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[1] Statement of Hon. William S. McKee, Acting Deputy Assistant Secretary (Tax Policy) before the Subcom. on Taxation and Debt Management Senate Finance Comm., on S. 825, S. Hrg. 98-186, at 18 (Apr. 29, 1983). The testimony appears only to focus on the "related" *vs.* "unrelated" aspect without regard to other specific or general exceptions.

[2] The Court of Claims opinion noted several times that the DAV had presented "no evidence" that their sale of lists was related to their exempt veterans function.

While, to the best of my knowledge, this statutory construction for Sec. 513(a)(3) has never been advanced before the Internal Revenue Service or the courts, I believe that this construction of the term "merchandise" is not at all at odds with the law of personal property; and an individual's name is personal property. *Brown Chemical Company* v. *Meyer*, 139 U.S. 540 (1891). H.R. 1773 serves to end any ambiguity in this area by achieving a clear and certain result and, in the interests of avoiding late administrative appeals and/or litigation, we would like to express our support for the clarifying amendment.

One other reason supporting enactment of the bill is that it affirms an administrative interpretation of the unrelated business income tax as now incorporated Regs. § 1.513-1(d)(4)(ii), Disposition of Product of Exempt Function. The regulation cited above exempts from tax the profitable sale of the "natural by-product" of an exempt function. As exemplified, the sale of articles made by the handicapped is not taxable to a rehabilitation center since the articles sold to the general public result directly from the conduct of a charitable or educational function, i.e., teaching the disadvantaged how to become productive through manufacture of repair of goods. If the rehabilitation center scrapped the manufactured or repaired goods, or gave them away, the training function would continue but would be impaired because the trainees would not have a concrete measure of the quality and value of their training when they move on to a commercially productive employment. In our case, the names and addresses of donors are a natural by-product of our fund raising function which is as charitable as the charitable programs we support with the funds we raise. See, e.g., *Trinidad* v. *Sagrada Orden*, 263 U.S. 578 (1924). When, and if, our charities choose to dispose of the names of their donors, they are merely doing something incidental to their exempt function by profiting from an article of property available to it arising as a by-product form the performance of an exempt function.

Although the Internal Revenue service has administratively approved this by-product doctrine even where there is a pervasiveness commercial presence, and probable anti-competitive impact of such "by-product" sales,[3] we would be reluctant to put forward such an argument in the United States Claims Court in light of the sweeping nature of Judge Merow's opinion in the *DAV* case.

The position of the Internal Revenue service in recent years has been to view as unrelated income any revenues from activities which resemble activities of commercial corporations, no matter how close the nexus between that activity and the exempt purposes of the organization. For example, the Service recently argued unsuccessfllly that no medical society journal advertising can be substantially related to the society's exempt function, because the advertising resembles commercial advertising. *The American College of Physicians* v. *United States*, Fed. Cir. No. 84-715, decided September 17, 1984. Similarly, in a recent case our office handled, the Service unsuccessfully argued that religious book publishing was nonexempt because it resembled commercial publishing, even though the 1909 legislative history of the predecessor of Section 501(c)(3) stated the contrary.[4] However, litigation proving one's point in this unevenly administered area is lengthy, and very expensive, and does not provide a uniform, nationwide rule for interested or affected organizations.

F. REASONS FOR ENACTMENT OF H.R. 1773

In last year's testimony, the Deputy Secretary for Tax Policy, on a similar Senate bill, conceded the social utility of donor mailing list exchanges.[5] Mr. McKee acknowledged that the maintenance of current donor lists is necessary for a charitable organization, and that the exchange and sale of membership lists between charities is routinely associated with that process.

The main reason for Treasury's opposition to legislation such as this was to preserve the purportedly clear policy line between exempt and commercial activities. As our discussion of current law indicates, however, the mere fact that an exempt organization engages in activities which resemble activities of commercial companies does not automatically subject the activity to tax under current law.[6] Many other factors need to be considered; and IRS conceded, in 1973, that a truly related enterprise can be as commercial as the market requires. Rev. Rul. 73-104, 1973-1 C.B. 263, dealing with the sale of Christmans cards by, for example, the Smithsonian Institution bookstore. The current bill will simply provide a clear exemption where it is admittedly needed, and very likely available under current law, while forestalling years of litigation and uncertainty on the question.

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[3] An agricultural college can sell milk tax free from its dairy herd maintained to teach students. Regs. § 1.513-1(d)(4)(ii).

[4] See *Presbyterian & Reformed Publishing Co.* v. *United States*, 54 A.F.T.R.2d 5730 (3d Cir. Aug. 29, 1984).

[5] Supra note 1, at 25-26.

[6] See generally, "Dealing with Investors and Other Methods of Generating Income: Tax Aspects of Revenue Producting Activities", 42nd Annual N.Y.U. Inst. on Fed. Tax., ch. 26 (1983)

In closing, let me raise one issue yet undiscussed—the possible revenue loss from this exemption. The tax revenues at stake here are very modest, probably less than $500,000 per year. Since its inception, the unrelated business income tax has not paid the Treasury any real substantial sums of money (see chart to our 1983 testimony) and never lived up to the revenue raising estimates published by the Congress in 1950 (see Aug. 30, 1950 Cong., Rec., p. 13951), even adjusted for inflation. The amount of tax foresworn by enacting this bill will be more than offset by the increased vigor of charitable solicitations which, in turn, will lessen the burdens of government relating to health, welfare and veterans' services. If AKF and AMVETS save $20,000 in federal taxes that sum is spent directly on charitable services and the federal fisc suffers no real loss due to our re-investment of the tax savings in the welfare of victims of kidney disease or needy veterans.

Chairman STARK. Thank you.

I guess I am uncertain as to whether the objection in this just comes on tax policy out of the IRS or whether there really are commercial fundraisers or mailing lists maintainers or whatever you refer to them as, who don't want you all competing against them on a tax-exempt basis.

Are there commercial operations that have objected?

Mr. HEILMAN. Mr. Chairman, during the DAV's court litigation, we had representatives from commercial mail order houses testify that the fact that the DAV was renting and exchanging its list, either with nonprofits, as we do mainly, or even with commercial groups, to the limited degree we do that, does not impact on them in any way, does not compete with them, does not affect their profit margin.

This type of activity is unique in that a list will either work for an organization or it won't. If its presence is there, you will use it, rent it, or exchange it; if it is not, you won't.

So they were not objecting at all to the fact that the DAV or other nonprofits rent and exchange their lists. And the court conceded this point in our case. But nonetheless, the court said it looks like a commercial activity, therefore, it is UBTI.

But the private industries did not object whatsoever.

Chairman STARK. I often wonder what would happen if they started to look into the practice of Members of Congress exchanging lists of fund contributors, either with their own political party or with other Members of Congress.

Ms. HATCH. You would have to start paying taxes.

Chairman STARK. That is a horrible thought, isn't it?

Mr. ALEXANDER. Mr. Chairman, the Treasury seems to be hung up on the reasoning that, No. 1, despite what Mr. Heilman said, that a charity that exchanges with another charity a limited right to mail to a name on its unique list is somehow engaging in a competitive activity.

Now, having reached that conclusion, then they discover that unless that competitive activity is taxed there is a competitive advantage to the charity, despite what Mr. Heilman said, and, therefore, one must eliminate the advantage by imposing a tax.

The problem with their reasoning is it is fallacious on points 1 and 2, and, therefore, on point 3.

Chairman STARK. Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman. I want to thank all of you for appearing.

It is obvious that the Internal Revenue Service is inconsistent in their interpretation of this issue. I am hopeful that we will be able to help you sometime early in the next Congress, because you certainly have a lot of friends here who are in sympathy with you.

There has been some concern expressed that this legislation results in an increase in mailing lists and in direct mail solicitations. How do you respond to this concern?

Mr. HEILMAN. Quite frankly, Mr. Duncan, I don't follow the logic that that question assumes—why it would result in an increase in the number of the lists. If the DAV is required to pay these taxes, we will continue in operation—if we can improve or expand our list, we will do so irrespective of the fact that we have to pay tax on our income or if we don't—and I imagine other charities will continue to try to improve their donor lists for their purpose of administering their programs—whether or not IRS is able to tax or not.

Certainly if this bill were not enacted and IRS really collects this money, I think it will definitely inhibit the ability of organizations, especially smaller ones, to maintain their lists and to improve their lists.

Mr. DUNCAN. Do you use your revenues from selling your mailing lists for any purpose not related to your tax-exempt purposes?

Mr. HEILMAN. No, sir. We certainly do not. As I indicated, the revenues that we do get from renting our lists are far and away offset by what we spend to identify and mail to those 900,000 potential donors to replace the ones we lose.

Mr. DUNCAN. Would you have to reduce your service to the disabled veterans and their widows and families without this revenue?

Mr. HEILMAN. Well——

Mr. DUNCAN. If you had to pay the taxes.

Mr. HEILMAN. Let me put it this way. If we didn't have to pay the tax, we certainly could increase our services to veterans. The DAV is very fortunate in that the general public has been most generous in contributing to our organization.

But as far as the smaller organization is concerned, and I am sure perhaps one of the other witnesses will attest to this, if they have to pay taxes, they very well might have to fold up shop.

Mr. DUNCAN. Mr. Lehrfeld, would you care to respond?

Mr. LEHRFELD. I think Ms. Hatch could probably respond best.

Ms. HATCH. Mr. Duncan, your question is a very good one, because the American Kidney Fund would definitely be affected by these taxes in that we would have to cut back on our programs and it wouldn't be us that would be suffering, it would be the kidney patients who are depending on our financial assistance that would suffer.

And it could eventually lead to the demise of the American Kidney Fund, and we are currently providing a supplement to the Federal and State programs for kidney patients.

Mr. DUNCAN. If you did not supply it, then the Federal Government would have to supply it, I suppose.

Ms. **Hatch**. They would not, I don't think so.

Mr. **Duncan**. You are at least giving a service and I think an excellent service. Thank you.

Thank you, Mr. Chairman.

Chairman **Stark**. We thank the panel.

Walter Stults, president of the National Association of Small Business Investment Companies, NASBIC.

STATEMENT OF WALTER B. STULTS, PRESIDENT, NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES

Mr. **Stults**. Thank you, Mr. Chairman.

Chairman **Stark**. You have a pass from the Treasury and with broad bipartisan support for your bill, you are doing as well as the Chicago Cubs.

Mr. **Stults**. I will let you go to lunch then.

Chairman **Stark**. Your entire statement will appear in the record.

If you would like to summarize it, proceed.

Mr. **Stults**. Fine. Thank you very much for this opportunity to allow me to give this testimony in support of H.R. 2686. Members of my association are small business investment companies licensed by SBA and business development companies which are venture capital companies.

These firms provide funds for new and growing small businesses and often provide significant managerial assistance.

We were delighted, obviously, by Treasury's OK for our legislation. We point out only that the problem addressed by this legislation was created when Congress enacted the Small Business Investment Incentive Act of 1980.

This set up a new regulatory framework under the SEC for certain publicly held venture capital companies. And the one problem was that we did not get the Internal Revenue Code amended at the same time we amended the Investment Company Act of 1940.

I would point out that this is a revenue neutral measure The Treasury Department has no objection.

The Senate has passed the measure, incidentally, twice, in 1981 and 1982, by unanimous vote.

Page 3 in my statement, Mr. Chairman, right in the middle, I made a mistake and said that "otherwise would have to register under the 1980 act." It should be the 1940 act."

To summarize, H.R. 2686 would provide necessary and deserved relief from a technical oversight. It would permit the full implementation of the Small Business Investment Incentive Act of 1980 and would not extend the special tax treatment provided in subchapter M of the code to any type of company that could not now claim the benefit of that treatment.

The amendments that this bill would make are important to a part of the venture capital industry, the industry that provides money and management assistance to new and growing businesses.

We urge Congress to enact H.R. 2686 at the earliest possible opportunity.

Thank you.

Chairman **Stark**. Thank you very much, Walter. I hope we can.

[The prepared statement follows:]

Statement of Walter B. Stults, President, National Association of Small Business Investment Cos.

Good morning Mr. Chairman and Members of the Subcommittee, my name is Walter B. Stults and I am President of the National Association of Small Business Investment Companies (NASBIC). I am here today to express NASBIC's support for H.R. 2686, which would amend subchapter M of the Internal Revenue Code to bring it into conformity with amendments to the Investment Company Act of 1940 made by the Small Business Investment Incentive Act of 1980.

The members of NASBIC are small business investment companies (SBICs), which are venture capital companies licensed by the Small Business Administration under the Small Business Investment Act of 1958. SBICs provide funds for new growing small businesses and also often provide significant managerial assistance.

Several SBICs and non-SBIC venture capital companies are publicly-owned companies whose shareholders are able to obtain a professionally managed and diversified portfolio of investments. Because these companies have characteristics similar to mutual funds, they are registered under the Investment Company Act of 1940 and are subject to the same SEC regulation as mutual funds. Also, like mutual funds, these SBICs are accorded special tax treatment under subchapter M of the Internal Revenue Code. Under subchapter M, a "regulated investment company," which is generally defined as a corporation registered under the Investment Company Act of 1940, can pass through to its shareholders its investment income without having to first pay Federal income taxes on those earnings at the corporate level. This allows small investors to diversify their investments and obtain professional investment management without having their investment earnings subjected to a second level of tax at the corporate level. This puts small investors on an equal footing with wealthy individuals who can avoid the second level of tax by making direct investments and directly hiring professional investment managers.

The problem addressed by H.R. 2686 was created when Congress enacted the Small Business Investment Incentive Act of 1980, amending the Investment Company Act of 1940. Under the 1980 Act, a new regulatory framework was established for certain public venture capital companies. To help make capital available for new, developing businesses, public venture capital companies that invest in and provide substantial management assistance to small, growing companies were allowed to claim exemption from the registration requirements of the 1940 Act and instead elect simplified regulation by the SEC as "business development companies." The only companies that can elect to be regulated as business development companies under the 1980 Act are investment management companies that otherwise would have to register under the 1980 Act. Unfortunately, this law has not been utilized by the majority of publicly-owned SBICs and venture capital companies because subchapter M of the Code allows pass-through tax treatment only to investment companies registered under the 1940 Act. The limitation of pass-through tax treatment to companies registered and regulated under the 1940 Act has also been a major deterrent to the formation of new publicly-owned SBICs and venture capital companies. The only publicly-owned SBICs and venture capital companies that have elected to give up registration under the 1940 Act are those companies that are not paying dividends and would currently gain no benefit from subchapter M.

H.R. 2686 would amend subchapter M of the Code to provide, in effect, that any business development company regulated under the 1980 Act will be treated as if it were registered under the 1940 Act. We understand the intention of H.R. 2686 is to remove any difference in tax treatment between a business development company and a company registered under the 1940 Act. Thus, any business development company that meets all other requirements of subchapter M of the Code would be treatd as a regulated investment company for all purposes of the Code, including the pass-through tax treatment under subchapter M. Also, under section 851(a)(1) of the Code, in determining whether a company has been at all times during the taxable year registered under the 1940 Act, a company that is a business development company under the 1980 Act for a part of a year would be treated under H.R. 2686 as if it were registered under the 1940 Act for that part of the year. Further, under section 851(e), relating to special portfolio diversity requirements for "registered management companies" (a sub-type of regulated investment company), a business development company under the 1980 Act would be treated under H.R. 2686 as a "registered management company." This is appropriate because if any business development company had not elected to be regulated under the 1980 Act it would have been a registered management company under the 1940 Act.

Mr. Chairman, this a revenue-neutral measure; the Treasury Department has no objection; and the Senate has passed the measure twice (in 1981 and 1982) by unanimous vote.

To summarize: H.R. 2686 would provide necessary and deserved relief from a technical oversight. It would permit the full implementation of the Small Business Investment Incentive Act of 1980 and would not extend the special tax treatment provided in subchapter M of the Code to any type of company that could not now claim the benefit of that treatment by subjecting itself to the unnecessarily burdensome registration requirements of the Investment Company Act of 1940. The amendments that H.R. 2686 would make are vitally important to a part of the venture capital industry that provides money and management assistance to small and growing businesses. We urge the Congress to enact H.R. 2686 at the earliest possible opportunity. I woud be pleased to try to answer any questions you may have at this time.

Chairman STARK. Our next panel is John K. Snyder, Jr., executive vice president, American Bus Association, and Paul Nagle, assistant to the executive director of the United Bus Owners of America.

We have prepared testimony from both of you. It will appear in the record in its entirety.

You may proceed, Mr. Snyder, to summarize your testimony in any manner you see fit, or expand on it in any way you would like.

STATEMENT OF JOHN K. SNYDER, JR., EXECUTIVE VICE PRESIDENT, AMERICAN BUS ASSOCIATION, ACCOMPANIED BY TIMOTHY HAAKE, TAX COUNSEL

Mr. SNYDER. Mr. Chairman and members of the subcommittee, I appreciate this opportunity to testify on behalf of the American Bus Association in favor of H.R. 3284.

I would like to submit my written statement for the record and will summarize its contents as follows:

My name is John Snyder. I am executive vice president of the American Bus Association. I am accompanied by Mr. Timothy Haake, tax counsel to the association.

The ABA is a national trade association of the intercity bus industry representing approximately 30,000 owners and operators across the United States.

With a fleet of 21,000 buses, the industry transported 370 million passengers in 1983. Our industry, including travel and tourism, contributes over $140 billion annually to the economy and constitutes the only means of transportation to and from many of this country's towns and communities.

We testify today in support of H.R. 3284 introduced by Congressman Ed Jenkins of Georgia, and cosponsored by many of the subcommittee members.

The bill would provide for the amortization of bus operating rights over a 5-year period. This is virtually the same relief granted to the trucking industry in 1981 following its deregulation in 1980.

We feel strongly that principles of tax equity require equal treatment for similarly situated taxpayers. The bus industry was deregulated in November 1982, bringing about the immediate worthlessness of operating rights issued by the ICC over the preceding 50 years.

This reduction in value of operating authorities has been noted in ICC accounting series circular No. 197 dated July 27, 1984, which directs all carriers to adjust their financial statements to reflect the fact that operating rights have nominal, if any, value. I would also like to point out that from the date of deregulation until July 2 of this year, the ICC has granted 99.8 percent of all requests for operating authorities. The net effect of this fact is that anyone can compete with established carriers. Thus the protection which was inherent in operating authorities prior to deregulation are now consistent, and those authorities are consequently worthless.

The worthlessness of these operating rights resulting from deregulation has had a severe negative impact on the financial status of our members.

Most operators have experienced a significant reduction in book value and find it much more difficult to finance new businesses as a result.

Even more distressing is the fact that many operators are paying on loans incurred for the purpose of purchasing operating rights which are now worthless.

At a time when most carriers are attempting to upgrade their fleets with more fuel efficient buses, this reduction in their ability to borrow has had a significant detrimental impact.

In closing, I would like to point out two additional facts.

First, 2 tax years have passed since our industry was deregulated. With each passing year it will become more difficult to comply with tax administrative requirements should this provision be enacted.

Additional costs for legal and accounting fees will certainly be incurred on the part of bus owners and operators.

Finally, we would like to point to section 20 of the Bus Regulatory Reform Act of 1982. At page 55 of the conference report, which calls for uniformity in the area of taxation between motor carriers of passengers and motor carriers of property.

On behalf of the members of the American Bus Association, I wish to thank the subcommittee chairman and the subcommittee members for the opportunity to testify on behalf of H.R. 3284.

I will attempt to answer any questions that the committee members may have.

[The prepared statement follows:]

STATEMENT OF JOHN K. SNYDER, JR., EXECUTIVE VICE PRESIDENT, THE AMERICAN BUS ASSOCIATION

Mr. Chairman and members of the Subcommittee, I appreciate this opportunity to testify on behalf of the ABA in favor of H.R. 3284. My name is John Snyder. I am Executive Vice President of the American Bus Association.

The American Bus Association is the national trade association for the inter-city bus industry. With a fleet of some 21,000 buses, the industry transported 370 million passengers in 1983. The Association has a membership of over 3,000, including bus owners and operators and others engaged in travel and tourism. Individual bus companies have become a vital element and, in some cases, the lifeline for travel and tourism which contributes $140 billion annually to the Nation's economy.

We are here today to express our support for H.R. 3284, which would provide for the amortization of bus operating rights. It is the position of the Association that because these operating rights are now worthless because of deregulation, a modification should be made to the Internal Revenue Code to permit their amortization, as has already been done with the trucking industry.

In 1935, Congress amended the Interstate Commerce Act by passing the Motor Carrier Act. The purpose of the legislation was to provide a regulatory framework for motor carriers of both freight and passengers. The primary regulatory feature of the Act was the establishment of a system of operating authorities or "rights" by which a motor carrier gained an exclusive concession to operate along a certain route.

During the period 1935 to 1980, the Interstate Commerce Commission (ICC) granted a limited number of permits and certificates of operating authority to motor carriers and freight forwarders. In order to secure a certificate of operating authority, the applicant was required to prove that:

1. The applicant was fit, willing and able to provide the transportation and comply with the ICC regulations, and;
2. That the transportation to be provided was or would be required by the present or future public convenience and necessity.

Holders of existing operating rights were empowered to intervene in a proceeding for a request of operating authority to show that the proposed service was not required by the public convenience and necessity.

The right of existing operators to intervene and the applicant's burden of showing that the proposed service was required by the public convenience and necessity gave existing opertors some protection against unwarranted competition. Persons wishing either to enter the motor carrier business or expand an existing business, often would purchase an existing business with its operating authority.

Substantial amounts were paid for these operating authorities. The value of the operating authorities provided owners with an asset that constituted a substantial part of a carrier's asset structure and a valuable source of loan collateral.

In 1979 and 1980, Congress undertook a study of motor carrier regulation and eventually approved the Motor Carrier Act of 1980 (PL 96-266), deregulating the trucking industry. Until the passage of the 1980 Act, both passenger and freight motor carriers were under the regulatory sanctions of the 1935 Act. Since the 1980 Act dealt only with motor carriers of property, the bus industry continued to be regulated under the 1935 legislation.

In its report on the 1980 Act, the House Public Works and Transportation Committee addressed the issue of operating rights by noting that if it should "become apparent that the effect of this legislation has been to substantially erode the value of operating rights, then appropriate relief for such results should be considered, as early as possible." [1]

The Congress did apparently find that the value of these rights was eroded since it granted tax relief in the same year that it passed the legislation to deregulate the industry. Such relief was included as part of the Economic Recovery Tax Act of 1981 (ERTA) (PL 97-34). Specifically, § 266 of ERTA states that, for taxpayers who, on July 1, 1980, held one or more motor carrier operating authorities, "an amount equal to the aggregate adjusted basis of all motor carrier operating authorities held by the taxpayer on July 1, 1980, or acquired subsequent thereto pursuant to a binding contract in effect on July 1, 1980, shall be allowed as a deduction ratably over a period of 60 months." [2]

On November 19, 1982, the Bus Regulatory Reform Act of 1982 (PL 97-261) became law. This legislation, which deregulated the inter-city bus industry, removed almost all barriers to entry into existing markets, established new guidelines for the bus industry's rate bureau, limited anti-trust immunity, and amended the minimum levels of financial responsibility required of bus operators. One of the most far reaching aspects of the legislation was the increased competition encouraged as a result of removing barriers to existing markets. For this reason, operating authorities issued by the ICC, which existing bus operators had acquired over the last 50 years, have been rendered valueless. For many bus companies, the operating authorities they held were the major assets on their balance sheets. The inherent value of such operating rights was recognized in October, 1979 by the ICC's Office of Policy and Analysis. In a study entitled, "The Value of Motor Carrier Operating Rights", the ICC clearly recognized an active market-place for operating rights which existed under ICC supervision and with its consent. While prices varied according to specific rights bought and sold, the study indicated that operating rights were a very real asset to a carrier, functioning much as tangible assets do to other industries. That is, operating rights were included in the value of an enterprise and were a source of collateral for borrowing.

Relying on the rules in existence prior to the 1982 Act, companies made substantial capital investment in such operating rights generally through purchase from other owners. These operating rights were listed as intangible assets on the balance sheet of the operator.

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[1] H.R. Rep. No. 1069, 96th Cong., 2nd Sess. 4, reprinted in 1980 U.S. Code Cong. & Ad. News 2286.

[2] Economic Recovery Tax Act of 1981, Pub. L. No. 97-34 § 266, 95 Stat 265-266 (1981).

The sudden diminution in value of these operating authorities brought about by the 1982 legislation has had a negative impact on the balance sheet of the holders. The reduction in the overall net worth of all companies holding operating authorities has come at a particularly bad time since the industry is attempting to upgrade its fleet through the acquisition of more fuel efficient buses. With the average operator owning between four and six buses and each bus costing approximately $145,000, it can easily be seen that the ability to borrow is essential to the well-being of individual operators. The severe reduction in net worth resulting from the reduction in value of operating authorities is therefore a major problem for our industry.

In addition, with the reduction in book value brought about by the 1982 legislation, some operators may be the target of acquisition attempts by other carriers or other industries seeking to acquire a transportation subsidiary. Mr. Chairman, I hope you would agree that it is important to correct the unanticipated results of bus deregulation and to ensure the continued viability and independence of the small entrepreneur.

Having suffered a severe loss in the value of operating rights, the members of the American Bus Association are unanimous in their support for the relief granted in H.R. 3284. In addition, I should mention that a similar bill, S. 1814, has been introduced by Senator Robert Packwood, Chairman of the Senate Commerce Committee and a member of the Senate Finance Committee. One result of deregulation on the bus industry is a reduction in asset value similar to a business loss. Operators currently are in possession of an asset which is worthless, which has not market value and which grants them rights that are no longer enforceable. The Internal Revenue Code at § 165 and other sections, recognizes the fact that tax relief should be granted in the case of expropriation, casualty, acts of God, and business related losses. In fact, the Congress has recognized several situations in the past where tax relief was deemed appropriate as a result of the consequences of federal legislation. For example, § 1071 of the Internal Revenue Code provides a special non-recognition provision concerning the sale or exchange of property pursuant to a change of policy or a new policy of the Federal Communications Commission. Similarly, § 1081 of the Internal Revenue Code provides for non-recognition of gain in an exchange or distribution in obedience to orders of the Securities and Exchange Commission. In addition, § 1101–1103 of the Internal Revenue Code grant specific relief to persons impacted by the bank holding company legislation which was enacted in 1956, 1966 and 1970. We feel therefore that amortization over 60 months of the adjusted book value of operating rights is in keeping with the spirit and policy of tax law. Moreover, passage of this legislation would extend to the bus industry to same treatment afforded the trucking industry in 1981 following its earlier deregulation.

With regard to the legislative history of the Bus Regulatory Reform Act of 1982, it is significant to note that § 20 of the Act provides for relief from tax discrimination as between the bus and trucking industry. The conference report on the Act (Rep. No. 97-780) at page 55, states that, "This provision makes current law which prohibits the assessment, levying or collecting of taxes on motor carrier property in a manner different from that of other commercial and industrial property applicable to motor carriers of passengers. The provision thus makes the law uniform for motor carriers of passengers and motor carriers of property. The prohibition applies to taxes on real or personal property, general sales taxes or other levies that are part of the general tax structure applicable to commercial activity. It does not apply to highway-user taxes." [3] This language clearly indicates that the intent of the legislation was to treat carriers of passengers in the same manner as carriers of property for tax purposes. It is the position of the American Bus Association that this language specifically identifies the need for the legislation introduced by Mr. Jenkins and in favor of which we are testifying here today.

Passage of this legislation would also clarify the confusion which exists in the eyes of bus owners and operators with regard to the treatment of such operating rights for tax purposes. Under generally accepted principles of accounting in effect prior to the enactment of the truck deregulation bill of 1980, operating rights acquired after 1970 had been amortized generally over a period not to exceed 40 years. The ICC did not permit amortization or disposition of carrying costs or operating rights unless there had been impairment of diminution of value. However, with the passage of the Motor Carrier Act of 1980, the ICC Bureau of Accounts approved the issuance of Accounting Series Circular No. 188, Accounting for Intangible Assets. The ICC changed its accounting to conform its practices with the new generally accepted principles of accounting which require an immediate, one-time deduction for book purposes, because such legislative actions and recent Commission decisions impaired or diminished the market value of carrier operating rights. Similarly, the ICC as recently issued Accounting Series Circular No. 197 dated July 27, 1984 directing all carriers to adjust their financial statements to reflect the fact that operating rights have "nominal, if any, value".

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[3] H.R. Rep. No. 780, 97th Cong., 2nd Sess. 55 (1982).

Conversely, the relief granted to the trucking industry in the ERTA of 1981, while offering general guidance to bus operators, is specifically limited to motor common or contract carriers of property who held such operating authorities on July 1, 1980. Clearly, motor common or contract carriers of passengers who held operating authorities on November 19, 1982 (the date of enactment of the Bus Regulation of 1982) do not fall within these legislative parameters. As a result there is clear confusion within our industry as to how these operating authorities which are now worthless should be treated for tax and accounting purposes. A legislative clarification by the Congress would bring certainty to our industry and eliminate the need for significant expenditures for legal and accounting assistance.

Mr. Chairman, in addition to the uncertainty concerning the proper tax treatment of operating rights following the 1982 legislation, there is another pressing reason why this legislation should be enacted this year. In addition to the need for a legislative solution as a matter of fairness and equity, the interests of sound tax administration require the prompt enactment of this legislation. As indicated, the Bus Deregulation Act was passed in 1982, this is the second full taxable year in which the issue of how these operating rights should be treated for purposes will be addressed by the thousands of bus owners and operators across the United States. If this legislation were postponed until 1985 or even 1986, it would result in the filing of thousands of amended returns with the Internal Revenue Service. Being mindful of the burdens under which that agency currently functions, it would be unfortunate to bring about an additional burden in the form of amended returns from bus owners and operators. From the perspective of the membership of ABA, it is also an inconvenience and expense which we would hope to be spared if possible. In addition, if there is a significant time gap between the actual reduction in value of operating authorities and the granting of tax relief, the negative impact on the financial position of individual companies will be exacerbated. It is for this reason, that we view the passage of H.R. 3284 as a natural and local concomitant to the 1982 Bus Regulatory Reform Act.

The comparative ease with which operating authorities can be secured from the ICC in the wake of deregulation is having a significant competitive impact on some of our smaller established carriers which I would like to share with the Committee. (In fact, the ICC reports that as of July 2, 1984 it has denied only two applications for operating authorities and granted 99.8% of all applications). This phenomenon impacts a typical small carrier which has borrowed heavily in order to purchase operating authorities prior to 1982. Following deregulation, such a company's net worth dropped precipitously, brought about by the worthlessness of the operating rights. Potential competitors of the established operator, who have secured their operating authorities at no cost from the ICC, and which have little or no debt, are in a much stronger borrowing posture than the established operator. The new competitor because of greater ability to borrow and because of little or no debt service obligation, can threaten the competitive position of the older more established operator. We are seeing this phenomenon fairly frequently. Its cause is the rapid devaluation of operating rights brought about by the 1982 legislation. Enactment of prompt tax relief, while not making the established operators completely whole, would be a major step toward stabilizing the financial posture of these carriers.

On behalf of the members of the American Bus Association, I wish to thank the Subcommittee Chairman and the Subcommittee members for the opportunity to testify on behalf of H.R. 3284 and I will attempt to respond to any questions which the members may wish to pose.

Chairman **Stark**. Thank you very much.

I might just announce here—I apologize to the audience or those witnesses waiting. It is my understanding that we have a vote coming up soon, in the next 15 or 20 minutes, on the floor, and at that time I would probably recess for at least 20 or 30 minutes.

But, for those panels following the freight forwarders—we have two more bills after this—so if the panel waiting for H.R. 4507 or

4167 or 4779, would like to get some lunch, I certainly figure they have a good half hour or so to do that.

You are welcome to stay, but I don't mean to keep you all sitting around as we plod through items which are not of interest to you.

The next witness, Mr. Nagle.

STATEMENT OF PAUL NAGLE, ASSISTANT TO THE EXECUTIVE DIRECTOR, UNITED BUS OWNERS OF AMERICA

Mr. NAGLE. Yes, sir. I am Paul Nagle. I am assistant to the executive director of United Bus Owners of America, a trade association comparable to that of the American Bus Association.

We have the same constituency roughly speaking. We have the same objectives. I certainly associate myself especially with the remarks of Mr. Snyder in closing when he pointed out the urgency of the timing of this matter, that each passing tax year makes recovery a bit more difficult.

I am especially pleased to be able to appear this morning in behalf of a bill which has already paid for itself. The savings in administering the motor carrier industry since 1982 when the bus carrier—when the Bus Regulatory Reform Act was approved, have been large, and they will be carried on at a rate substantially lower than those preceding 1982 for the balance of all time that the Commerce Act is in effect.

Consequently, the economy that is involved here, the dollar savings are really pronounced.

Furthermore, the equity of the matter is that until now, until the passage of the Bus Regulatory Reform Act, the assets of operating authorities were carried on the books of the various carriers precisely as assets.

They could not be deducted, not be taken advantage of in any way, and, as Mr. Snyder pointed out, suddenly they became valueless. Consequently, from the dollars which are being saved and the equity which manifestly exists, we think it would be highly appropriate that H.R. 3284 should be approved, with one amendment.

There is a $5 million cap in the bill which we think is inappropriate. We believe that the $5 million cap has no special use. We believe it is discriminatory.

Chairman STARK. If I can interrupt you at that point.

Mr. Snyder, does your association support removing the $5 million cap as well?

Mr. NAGLE. We support the bill without the $5 million cap.

Chairman STARK. Mr. Snyder.

Mr. SNYDER. The association would like to see passage of this bill as soon as possible. We would really like to defer to the judgment of Congress with regard to any limitations imposed on the deduction.

I might add if the cap was proposed, the association would still support the bill.

Chairman STARK. OK. It is no secret that Greyhound, who is a significant player in this arena, opposes it. You would speak with a little more unanimity from the industry if there was not opposition to the removal.

I wanted that to be clear.

Proceed, Mr. Nagle.

Mr. NAGLE. Yes, sir.

My understanding is that were the cap to be removed, there would be an additional cash outlay of approximately $6 million and $6 million, of course, in the terms of our budget, is a very trifling sum.

Furthermore, as I have already indicated, I hope rather strongly, the moneys have been saved countless times over already. Therefore, Mr. Chairman, if I may make the final recommendation that we hope the cap can be removed and that the bill can be adopted speedily.

The Senate version of the bill does not contain a cap. We think that following suit with the Senate would be a highlv laudable legislative gesture.

Thank you very much, sir.

[The prepared statement and letter subsequently received follow:]

STATEMENT OF PAUL NAGLE, UNITED BUS OWNERS OF AMERICA

Mr. Chairman, my name is Paul Nagle. I am assistant to the executive director of the United Bus Owners of America (UBOA), the largest trade association serving the intercity bus industry, 2,000 operators of regular routes and providers of charter and special transportation. Our constituency includes both Greyhound and Trailways, and a number of their affiliated carriers.

The consensus of our membership is that we support, enthusiastically, the concept that there should be tax amortization of investments in operating authority. During the period prior to enactment of the Bus Regulatory Reform Act of 1982 (BRRA or the Bus Act) such investments were the customary method for securing access to certificates of public convenience and necessity.

Mr. Chairman, UBOA perceives H.R. 3284 to be a first step on the road to Congressional recompense for losses which came about by reason of Congressional action. When the Bus Act made its commendable improvements in the methods whereby motor carrier applicants are adjudged to merit award of authority to transport passengers, operating certificates underwent, at the stroke of the Presidential pen, a wipe-out of cash value.

Just as the Bus Act affords substance to the concept of tax amortization of purchases of operating authority, so too, would the amortization process tend to relieve a pattern of social hardships which were engendered by the Bus Act.

Mr. Chairman, the premises for State and Local opposition to the Bus Act were, plaintly and flatly, that given exemption from compulsive control by State and Local regulatory bodies, regular route carriers would seek to exit from routes which were not self-sustaining; that they would not continue, ad infinitum, to cross-subsidize their operations; to operate coaches in regular route service, in order by that continued operation to go on enjoying the benefits of "incidental charter rights."

Mr. Chairman, one of the laudable provisions of the Bus Act (and there are many) is the requirement that, through 1985, there be annual oversight hearings both in the Senate and the House of Representatives; that there be surveillance over the stewardship demonstrated by the cognizant administrative bodies.

Just yesterday, October 2, there was concluded the 1984 series of those hearings. Before the Surface Transportation Subcommittee of the Public Works and Transportation Committee, Interstate Commerce Commission Chairman Reese H. Taylor, Jr., as the sole presentor of oral testimony, described the pattern of operations by motor carriers of passengers, in the period since the Bus Act became effective.

In those hearings, everyone's attention focused upon exit, upon a desire by regular route carriers to divest themselves of the "common carrier obligation" to provide service to all entities covered in each recipient's "certificate of public convenience and necessity."

True, the Bus Act does afford to regular route carriers, an escape from the stultifying State-sponsored commitment that a certificated carrier provide service without regard to any level of remuneration.

The entire purpose of the Bus Act, as perceived by UBOA, is to bring order into a chaotic marketplace where, historically, operating rights have been auctioned—as always, in an auction—at a price. The concept of H.R. 3284, in the eyes of UBOA, is one which redresses to the buyer a balance which prevailed before Congress changed the rules.

UBOS has been strongly supportive of Reese H. Taylor, Jr., Chairman of the Interstate Commerce Commission. Throughout Chairman Taylor's testimony, and in the pattern of yesteday's follow-up questions, there was one over-riding theme: The Bus Act impacts negatively upon small towns and rural communities.

Characteristically, UBOA's membership concentrates on charter and special transportation. Our members who perform scheduled service, the number of whom is sizable, do so as appendages to the national networks of Trailways and Greyhound. Here, in the National Capital Area, there has been a recent change in the pattern of operations of Eyre Bus Service. On the West Coast, a bi-modal contract with Amtrak has moved from one UBOA member to another. But, in Chairman Taylor's testimony, the only proper names to be used, were those of Trailways and Greyhound. Questioning of Chairman Taylor had a one-note theme: How do we sustain service to small communities which, either Trailways or Greyhound, no longer can serve in a self-sustaining mode?

In short, impact of the Bus Act was observed, not from a broadening perspective of increasingly attractive group travel, but from a narrowing viewpoint of decreasingly attractive scheduled operations.

This is the bottom-line. This is the thrust. It is imperative that regular route service be restored to viability. When all peripheral issues are exploded, the one reality persists: Trailways and Greyhound are the lifelines of regular route operations. H.R. 3284 is tremendously important to companies such as Baltimore Motor Coach which swims, today, against a tide that underwent a sea-change when the Bus Act became law. Investments by the Baltimore Motor Coach type of company in purchases of operating authorities, acquisitions of priceless certificates, became worthless.

H.R. 3284 would offer a bookkeeping benefit to companies such as Baltimore Motor Coach. H.R. 3284 would open to the principal carriers, Greyhound and Trailways, an avenue upon which to continue to serve rural America. For the smallest and the largest carriers, the advantages of H.R. 3284 are of a bookkeeping character. But who of us does not live by the books which are kept? Accordingly, UBOA suggests that there is unreality in the five million dollar upward limits in the amortizations which are proposed to be set by H.R. 3285. UBOA proposes, Mr. Chairman, that the $5 million figure is extraneous; that it is counter-productive to the purposes of the Legislation; that, properly and purposefully, the $5 millon limit should be excised, eliminated.

Mr. Chairman, the Senate Bill, S. 1814, contains no restriction such as the $5 million cap contained in H.R. 3284. We commend to your attention the language of S. 1814, and pray that the Senate version be accepted as an amendment in the nature of a substitute, thereby expediting passage.

Except for the unrealistic ceiling, UBOA supports H.R. 3284. We urge that it be modified and approved. We appreciate the opportunity to lay our views before you.

Thank you.

UNITED BUS OWNERS OF AMERICA,
Washington, DC, October 11, 1984.

Hon. FORTNEY H. STARK,
Chairman, Subcommittee on Select Revenue Measures,
House Committee on Ways and Means, Washington, DC.

DEAR MR. CHAIRMAN: We have returned to Mr. Salmon, the transcript of our testimony before your Subcommittee on October 3, 1984.

We commented to Mr. Salmon that the transcription had been accomplished, superbly; that we made no corrections.

However, we do note an error on Page 128, where on Line 2739, the American Bus Association claims a membership of 30,000 members. Actually, the total of all passenger carriers, including mass transit agencies is approximately 4,000. UBOA's verified membership is 2,000, double the number enrolled by the American Bus Association.

From the perspective of UBOA, we thought it appropriate to offer this clarification.

Sincerely,

PAUL A. NAGLE,
Assistant to the Executive Director.

Chairman STARK. Thank you.

Mr. Duncan.

Mr. DUNCAN. No questions.

Chairman **Stark**. Thank you very much.

We would like to call William Morris to testify on H.R. 3388.

Mr. Morris, we have your prepared testimony. Without objection, it will appear in the record in its entirety. You may summarize it or supplement it in any manner you feel comfortable.

STATEMENT OF WILLIAM MORRIS, COUNSEL, ON BEHALF OF FRED T. FRANZIA, JOHN G. FRANZIA, JR., AND JOSEPH S. FRANZIA, CERES, CA

Mr. **Morris**. Thank you very much, Mr. Chairman. I am Bill Morris. I am a partner with the law firm of Rogers & Wells in our Washington, DC office. I am going to be extremely brief.

I am here simply to request that the subcommittee and the full committee approve H.R. 3388, which is a bill identical to a measure that has already been approved by the full committee and the House of Representatives and the Committee on Finance on the Senate side during the last Congress. That bill was H.R. 4577.

The Treasury had some comments on H.R. 3388 which I would just like to take a second to address. They made two points. The first was that this measure is retroactive. The second point was that it would reopen years that are closed by the statute of limitations.

With respect to the first point, which is that it is retroactive, there are a series of examples in the prepared statement indicating numerous instances where the Congress has acted under such circumstances.

With respect to the second point about reopening closed years, that statement is incorrect.

The years under consideration are actually open and the subject of pending Tax Court cases.

If you have any questions, Mr. Chairman, I would be happy to answer them at this time.

[The prepared statement follows:]

Statement of William Morris, Counsel, on Behalf of Fred T. Franzia, John G. Franzia, Jr., and Joseph S. Franzia, Ceres, CA

SUMMARY

1. H.R. 3388 would permit certain individuals who received stock in 1973 pursuant to the exercise of employee stock options to elect to have section 252 of the Economic Recovery Tax Act of 1981 apply under certain limited circumstances. Under the bill, any reduction in tax pursuant to such election could not exceed $100,000 with respect to any one employee. The bill would amend the statute of limitations to permit refunds, credits, or assessments, attributable to the provisions of the bill.

2. Federal restrictions which effectively deny certain employees (referred to as "insiders") the ability to dispose of stock for a fixed period of time after receipt of the stock should be taken into account and no tax on any gain in value should be imposed until such time as the Federal restrictions (Section 16(b) of the Securities Exchange Act of "Pooling-of-Interests Accounting" rules) lapse and the employee is free to sell his stock, whether the transaction takes place before or after December 31, 1981.

3. There is ample precedent for the Congress to extend the revised rules added as an amendment to Section 83 of the Code by P.L. 97-34 to taxpayers whose taxable years remain open under the statue of limitations or are the subject of pending cases. For example, in the Deficit Reduction Act of 1984 (P.L. 98-369), the Congress agreed to permit employees who received property subject to tax under Section 83 to elect to treat the full value of the property received over the amount paid as ordinary income in the year in which the transfers occurs rather than in the first year

the property is transferrable. The provision only applies to transfer of property made after June 30, 1976, and before November 18, 1982. Moreover, the Committee on Ways and Means and the full House of Representatives has already approved an identical measure to H.R. 3388 in September of 1982.

STATEMENT

My name is William Morris. I am a partner with the law firm of Rogers & Wells with offices in New York City, Los Angeles, San Diego, Washington, D.C., London, England, and Paris, France. The written testimony submitted is on behalf of three individuals, Messers. Fred T. Franzia, John G. Franzia, Jr. and Joseph S. Franzia, with offices in Ceres, California. We are requesting the members of this subcommittee and those of the full Committee to once again give favorable consideration to the substance of H.R. 3388.

This bill would amend P.L. 97-34, The Economic Recovery Tax Act of 1981, by revising the effective date of Section 252 of that Act to provide that it would apply to certain transactions that occurred in taxable years still open under the statute of limitations as the subject of pending Tax Court cases. The revised effective date we seek is in substance the same effective date the Ways and Means Committee approved on July 22, 1981, when it agreed to amend Section 83 of the Internal Revenue Code (IRC) which contains rules for the taxation of property transferred by an employer to an employee.

Generally, if property (including stock) received by an employee is not transferable or is subject to a substantial risk of forfeiture (such as the obligation to perform future services), taxation is postponed until the stock or other property is transferable or is no longer subject to a substantial risk of forfeiture. In construing this general rule the IRS has argued that Section 16(b) of the Securities Exchange Act of 1934, under which an "insider's" profit may be recovered by a corporation if the stock is sold within six months of receipt, does not make the stock nontransferable, and therefore does not affect the taxaton of the stock. Thus, the value of the stock (less any amount paid) is treated as compensation when received, by the IRS.

During Ways and Means Committee consideration of the Economic Recovery Tax Act of 1981, we brought this matter and similar situations to the attention of the members of the full committee. On July 22, 1981, the Ways and Means Committee, after two roll call votes, of 25-5 and 21-9, agreed to revise the tax treatment for stock received by an employee subject to the restrictions of Section 16(b) of the Securities Exchange Act of 1934. The Committee, at page 263 of its Report to accompany H.R. 4242 (H. Rept. 97-201, July 24, 1981) stated:

"The committee believes that the imposition of Federal restrictions, which limit the ability of an "insider" to dispose of stock for a short period of time after receipt, should be taken into account in determining the manner in which the value of the stock should be included in income. Because of mandated restriction on transferability, the committee believes it may be inequitable to tax the employee before the restriction lapses."

The Report then explained the provisions approved, which consisted of two parts, the first providing that stock received subject to section 16(b) or the Securities Exchange Act of 1934 would be treated as being subject to a substantial risk of forfeiture and the second providing that stock subject to the Securities and Exchange Commission's "Pooling-of-Interests Accounting" rules would be similarly treated.

Finally, because of the unduly harsh result under the IRS' interpretation of Section 83, imposing Federal income tax on income that has not been realized and may never be realized, the Committee agreed to make the provision applicable to all taxpayers who could be affected by the change and who were eligible to file amended returns or claim relief in cases presently pending before the Courts, if the taxpayer elected the relief provided.

Subsequently, the House agreed to substitute the Administration-backed Conable-Hance substitute for H.R. 4242 as reported by the Ways and Means Committee. In approving the substitute, the relief granted under this provision was limited to only transactions occurring after 1981. The provision, as approved as part of the Conable-Hance substitute was then agreed to by House-Senate Conferees and was signed into law as part of P.L. 97-34 on August 13, 1981.[1]

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[1] It should be noted that Congressional approval of this provision represents a partial acceptance of an original Treasury Department proposal put forward in 1969 When Section 83 was first made a part of the Internal Revenue Code. The Treasury Department urged at that time, but the Ways and Means Committee rejected without explanation, a proposal to permit Federal

Continued

In approving the addition of subsection (c)(3) to Section 83, the Congress recognized the fundamental unfairness of determining taxable income before it is possible to realize that income. In correcting similar inequitable situation in the tax laws, the Congress has attempted to extend the benefit of remedial legislation to all those who could qualify within the framework of the normal rules for the collection of taxes and filing of claims for refund and has generally not limited relief to merely those who would be "wronged" after some arbitrary future date.

For example, in 1971 Public Law 91-679, January 12, 1971) the Congress approved legislation adding subsection (e) to Section 6013 to correct the unfairness of prior law under which individuals filing joint income tax returns could be held liable for additional taxes and the 50 percent fraud penalty as a result of the fraudulent omission of income on a joint return by their spouse, even though they had no knowledge of their spouse's activities and omission of income and derived no benefit from the use of such funds.

The amendments approved to correct this situation were made applicable to all taxable years covered by the Internal Revenue Code of 1954. Only taxpayers whose taxable years could not be opened under the statute of limitations or whose cases were closed and barred from reopening under the doctrine of res judicata were not covered by the statutory change.

More recently, in 1984, the Deficit Reduction Act, (P.L. 98-369, July 22, 1984) contained a provision reversing the holding in the *Alves* case (79 T.C. 864, aff'd 734 F.2d 479, 9th Cir. 1984). The *Alves* case confirmed the position of the IRS that Section 83 of the Code requires an employee who has received restricted stock in connection with the performance of services to include as ordinary income the stock's appreciation in value between the time of purchase and the time the restrictions lapse, unless within 30 days after the stock is received, the employee elected to include as income the difference between the purchase price and the fair market value of such stock. The Congress, in the Deficit Reduction Act, has allowed a taxpayer to retroactively make the election under Section 83(b) to include the full fair market value of the property in income with the first tax return filed after July 22, 1984, with respect to transfers of property made after June 20, 1976 and before November 18, 1982, if the taxpayer paid fair market value for the property and the employer consents to the election.

In 1978, Public Law 95-628 (May 10, 1978) was approved, revising various timing requirements under the tax laws. This measure included a provision applicable to subchapter S corporations and the filing of an effective election to be treated as a subchapter S corporation. The rules for filing such elections were liberalized and the time period extended. In addition, a special rule was incorporated in the provision to permit subchapter S corporations to perfect their elections for all prior taxable years, without limitation.

Also in 1978, after the Supreme Court in *Commissioner* v. *Kowalski*, 434 U.S. 77 (1977) finally resolved the conflict among the various appellate courts over the issue of whether cash meal allowances paid to state troopers were not subject to tax under Section 119. The Congress provided that statutory subsistence allowances should only be subject to Federal income tax prospectively and that such allowances should be excluded from tax during the years 1970 through 1976. See P.L. 95-427 (October 7, 1978) and H. Rept. 95-1232. An important factor brought to the attention of the Congress regarding the impact of the *Kowalski* decision was that in a number of cases, if the Court's decision were not made prospective, the total additional tax due together with interest for the period 1970-1976 could exceed the annual salaries of some state troopers.

In the instant case, the situation is even more egregious. Taxpayers are being required by the IRS to include in income gains which were never realized and in fact, could never be realized. In fact, in 1982 the Ways and Means Committee and the full House of Representatives recognized the inequity and approved H.R. 4577 to provide the relief we now request. H.R. 4577 was also approved by the Senate Finance Committee, but was not finally approved by the full Senate prior to the adjournment of the 98th Congress as a result of certain procedural problems.

In Public Law 97-34, The Economic Recovery Tax Act of 1981, the Congress recognized the inequity involved in taxing employees on the receipt of stock which they are effectively prohibited from selling at a profit for a six-month period. In urging the adoption of the substance of H.R. 3388, we are simply asking that the inequity

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Securities law restrictions to be taken into account in determining the fair market value of restricted stock. See Technical Explanation of Treasury Tax Reform Proposals, Hearings Before House Committee on Ways and Means on the Subject of Tax Reform, 91st cong., 1st Sess., 5206-07.

previously removed for past transactions as well as future transactions by the full Ways and Means Committee on July 22, 1981, and again on September 16, 1982, as H.R. 4577 be approved by this Committee so those individuals who may still do so without bar under the normal statute limitations and within the context of a pending case may be granted the same tax treatment as those persons to whom Section 83(c)(3) applies after December 31, 1981.

Attached is a copy of the House Ways and Means Committee Report on H.R. 4577 (House Report No. 97-830, Sept. 16, 1982) favorably reporting H.R. 4577, a measure identical to H.R. 3388, the measure for which we seek your approval today as well as the pertinent pages from the Ways and Means Committee Report on H.R. 4242 (House Report 97-201, July 24, 1981) explaining the above noted amendments approved to Section 83 of the Code.

In testimony presented to the House Ways and Means committee Subcommittee on Select Revenue measures on March 16, 1982, then Assistant Secretary of the Treasury, John E. Chapoton criticized an earlier bill similar to H.R. 3388 on three grounds: (a) the relief is retroactive, (b) it provides relief for years otherwise barred by the statute of limitations and (c) it provides taxpayers the option of electing the "old" rules or "new" rules.

We submit each of these grounds is without merit:

(a) As indicated in our written comments above, there are a number of cases in which the Congress has provided retroactive relief to correct harsh and inequitable results under the tax laws. These precedents clearly rebut any rationale for the need to blindly and without regard to fundamental principles of fairness, due to a general rule designed to bar retrospective legislation. To the contrary, the law abounds with curative statutes designed to correct patently unjust results.

(b) The technical correction proposed only applies to certain individuals whose taxable years remain open for purposes of assessment, collection, credit or refund. It would not permit individuals, otherwise barred by the statute of limitations, to open or reopen "closed" years.

(c) No election to use "old" rules or "new" rules is proposed. Taxpayers, to be eligible for the equitable relief provided, are simply required to affirmatively request such relief.

Thank you for providing us with the opportunity to present our case to the committee. We hope you share our concern about the fundamental unfairness of the present situation and recognize the extensive precedent that exists for extending the relief approved in P.L. 97-34 to certain taxpayers not barred by the statute of limitations who have cases pending before the courts and who affirmatively request such relief.

97TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
No. 97-830

APPLICATION OF SECTION 252 OF ECONOMIC RECOVERY TAX ACT OF 1981 TO CERTAIN TRANSFERS IN 1973

SEPTEMBER 16, 1982.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. ROSTENKOWSKI, from the committee on Ways and Means, submitted the following

REPORT

[To accompany H.R. 4577]

The Committee on Ways and Means, to whom was referred the bill (H.R. 4577) to amend Public Law 97-34, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Strike our all after the enacting clause and insert in lieu thereof the following:

That (a) IN GENERAL.—Notwithstanding subsection (c) of section 252 of the Economic Recovery Tax Act of 1981, the amendment made by subsection (a) of such section 252 (and the provisions of subsection (b) of such section 252) shall apply to any transfer of stock to any person if—

(1) Such transfer occurred in November or December of 1973 and was pursuant to the exercise of an option granted in November or December of 1971,

(2) in December of 1973 the corporation granting the option was acquired by another corporation in a transaction qualifying as a reorganization under section 368 of the Internal Revenue Code of 1954,

(3) the fair market value (as of July 1, 1974) of the stock received by such person in the reorganization in exchange for the stock transferred to him pursuant to the exercise of such option was less than 50 percent of the fair market value of the stock so received (as of December 4, 1973),

(4) in 1975 or 1976 such person sold substantially all of the stock received in such reorganization, and

(5) such person makes an election under this section at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe.

(b) LIMITATION ON AMOUNT OF BENEFIT.—Subsection (a) shall not apply to transfers with respect to any employee to the extent that the application of subsection (a) with respect to such employee would (but for this subsection) result in a reduction in liability for income tax with respect to such employee for all taxable years in excess of $100,000 (determined without regard to any interest).

(c) STATUTE OF LIMITATIONS.—

(1) OVERPAYMENTS.—If refund or credit of any overpayment of tax resulting from the application of subsection (a) is prevented on the date of the enactment of this Act (or at any time within 6 months after such date of enactment) by the operation of any law or rule of law, refund or credit of such overpayment (to the extent attributable to the application of subsection (a)) may, nevertheless, be made or allowed if claim therefor is filed before the close of such 6-month period.

(2) DEFICIENCIES.—If the assessment of any deficiency of tax resulting from the application of subsection (a) is prevented on the date of the enactment of this Act (or at any time within 6 months after such date of enactment) by the operations of any law or rule of law, assessment of such deficiency (to the extent attributable to the application of subsection (a)) may, nevertheless, be made within such 6-month period.

Amend the title so as to read:

A bill to provide that the provisions of section 252 of the Economic Recovery Tax Act of 1981 (relating to transfers of property to employees subject to certain restrictions) shall apply to certain transfers occurring during 1973.

I. SUMMARY

The bill permits certain individuals who received stock in 1973 pursuant to the exercise of employee stock options to elect to have section 252 of the Economic Recovery Stock Act of 1981 apply retroactively in certain limited circumstances. Under the bill, any reduction in tax pursuant to such election could not exceed $100,000 with respect to any one employee. The statute of limitations is amended by the bill to permit refunds or credits, or assessments, attributable to the provisions of the bill.

II. EXPLANATION OF THE BILL

Present Law

In General

Under the present law rules relating to transfers of property in connection with the performance of services (Code sec. 83), an employee generally includes in income the fair market value of transferred property, less any amount paid for the property, when the property first becomes either transferable or not subject to a substantial risk of forefeiture.[1] Thus, if an employee receives property that is both subject to a substantial risk of forfeiture and is not transferable, the employee generally is not taxed until the property becomes either transferable or not subject to a substantial risk of forefeiture. The amount the employee includes in income is equal to the fair market value of the transferred property (as of the time of taxation), less any amount the employee paid for the property.

However, an employee may elect (under sec. 83(b)) to be taxed when the property is received.[2] In that case, the employee includes an amount in income equal to the fair market value of the property when received less any amount paid for the property.

Effect of restrictions

Generally, under section 83, restrictions on property are not taken into account in determining the fair market value of the property. Also, property is considered transferable for purposes of section 83 when the property would not be subject to a substantial risk of forfeiture in the hands of a subsequent transferee.

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[1] An employer generally is allowed a business expense deduction, when the employee is taxed, equal to the amount includible in the employee's income (sec. 83(h)).

[2] See note 1.

Prior to enactment of section 252 of the Economic Recovery Tax Act of 1981 (ERTA), the U.S. Tax Court had ruled [3] that stock subject to the "insider trading" rules of section 16(b) of the Securities Exchange Act of 1934 [4] was transferable within the meaning of section 83. Thus, although the taxpayer's profit on a sale of the stock within six months of reciept could be recovered by the corporation, the taxpayer was taxable on the fair market value of the stock when received.

As amended by section 252 of ERTA, section 83 provides that stock subject to the restrictions of section 16(b) of the Securities Exchange Act of 1934 is treated as being subject to a substantial risk of forfeiture and nontransferable for the six-month period following receipt of the stock during which that section applies. Thus, unless the taxpayer elects (under sec. 83(b)) to be taxed when the stock is received, the taxpayer must include in income (and the employer may deduct), at the expiration of the period during which section 16(b) is applicable, the value of the stock at such time, less any amount the taxpayer paid for the stock. A similar rule is provided for stock subject to restrictions on transfer by reason of complying with the "pooling-of-interests" accounting rules of Accounting Series Releases Numbered 130 ((10/5/72) 37 FR 20937; 17 CFR 211.130)) and 135 ((1/18/73) 38 FR 1734; CFR 211.135)).

The amendments made to section 83 by section 252 of ERTA apply to taxable years (of the transferee) ending after December 31, 1981.

Reasons for Change

The committee has been advised of a situation in which, prior to the effective date of ERTA section 252, stock acquired by several shareholder employees pursuant to the exercise of an option underwent a substantial diminution in value while both section 16(b) of the Securities Exchange Act of 1934 and the restrictions on transferability to comply with the "pooling-of-interests" accounting rules were in effect. The committee has concluded that in this situation, as under the rules enacted by ERTA, such shareholder employees should not be required to treat as compensation the value of the stock while subject to such limitations.

Explanation of Provisions

Under the bill, the rules of section 252 of ERTA will apply if (1) stock was acquired in November or December of 1973 pursuant to options granted in November or December of 1971, (2) the corporation granting the options was acquired in a reorganization during December 1973, and (3) the fair market value of the stock in the acquiring corporation as of July 1, 1974, received in exchange for the stock acquired on exercise of the option, was less than 50 percent of its value on December 4, 1973. This relief under the bill will be allowed only at the election of a shareholder who during 1975 or 1976 sold substantially all the stock so received.

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[3] *Horwith* v. *Comm'r*, 71 T.C. 932 (1979).

The bill will not apply with respect to a transfer to any employee to the extent that its application would result in a reduction in tax liability (exclusive of interest) of such employee in excess of $100,000 for all taxable years.

Also, the bill provides that a refund or credit of any overpayment of tax, or an assessment of any deficiency, which is attributable to provisions of the bill, and which otherwise would be barred within six months after the date of enactment, may be made or allowed to the extent attributable to application of provisions of the bill, provided that, in the case of a credit or refund, a claim therefor is filed within such six-month period.

The provisions of the bill may affect the tax liability of an electing person for the year in which stock was sold, as well as the amount of compensation and the year of its inclusion in income. The bill may also affect the amount and timing of any deduction allowable to the employer corporation. The statute of limitations is to be kept open for the purpose of making such adjustments.

The intended beneficiaries of this bill are John G. Franzia, Jr., Joseph S. Franzia, and Fred T. Franzia.

Effective Date

The bill will have only retroactive effect, and only to the limited extent provided in the bill and described in the explanation of the provisions of the bill.

III. EFFECT OF THE BILL ON THE BUDGET AND VOTE OF THE COMMITTEE IN REPORTING THE BILL

Budget effects

In compliance with clause 7 of Rule XIII of the Rules of the House of Representatives, the following statement is made about the effect on the budget of this bill, H.R. 4577. The comittee estimates that the provisions contained in the bill, H.R. 4577, as amended will reduce budget receipts by a negligible amount.

The Treasury Department agrees with this statement.

Vote of committee

In compliance with clause 2(l)(2)(B) of Rule XI of the Rules of the House of Representatives, the following statement is made about the vote of the committee on the motion to report the bill, as amended. The bill, H.R. 4577, as amended, was ordered favorably reported by voice vote.

IV. OTHER MATTERS TO BE DISCUSSED UNDER HOUSE RULES

In compliance with clauses 3(l)(3) and 2(l)(4) of Rule XI of the Rules of the House of Representatives, the following statements are made with respect to the committee action on H.R. 4577, as amend-

Oversight findings

With respect to subdivision (A) of clause 2(l)(3) (relating to oversight findings), the committee advises that it was as a result of the committee's oversight activities with respect to the treatment of certain stock options that the committee concluded that it is appropriate to enact the provisions contained in the bill.

The Subcommittee on Select Revenue measures held a hearing on March 16, 1982, and ordered the bill favorably reported on July 12, 1982, with amendments. The Subcommittee transmitted a report to the full committee on September 10, 1982.

New budget authority and tax expenditures

With respect to subdivision (B) of clause 2(l)(3), after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by this bill involve no new budget authority or new or increased tax expenditures.

Consultation with congressisonal budget officials on budget estimates

With respect to subdivision (C) of clause 2(l)(3), the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates (as indicated in part III of this report) and agrees with the committee's budget estimates.

Oversight by Committee on Government Operations

With respect to subdivision (D) of clause 2(l)(3), the commitee advises that no oversight findings or recommendations have been submitted to the committee by the Committee on Government Operations regarding the subject matter of this bill.

Inflationary impact

In compliance with clause 2(l)(4), the committee states that the enactment of this bill is not expected to have an inflationary impact on prices and costs in the operation of the national economy.

V. PROVISIONS OF EXISTING LAW REFERRED TO IN THE BILL, AS REPORTED

For the information of the Members of the House of Representatives, the following provisions of existing law are referred to in the bill, as reported:

SECTION 252 OF THE ECONOMIC RECOVERY TAX ACT OF 1981

SEC. 252. PROPERTY TRANSFERRED TO EMPLOYEES SUBJECT TO CERTAIN RESTRICTIONS.

(a) GENERAL RULE.—Subsection (c) of section 83 (relating to special rules) is amended by adding at the end thereof the following new paragraph:

"(3) SALES WHICH MAY GIVE RISE TO SUIT UNDER SECTION 16(b) sale of property at a profit could subject a person to suit under section 16(b) of the Securities and Exchange Act of 1934, such person's rights in such property are—

"(A) subject to a substantial risk of forfeiture, and

"(B) not transferable."

(b) SPECIAL RULE FOR CERTAIN ACCOUNTING RULES.—For purposes of section 83 of the Internal Revenue Code of 1954, property is subject to substantial risk of forfeiture and is not transferable so long as such property is subject to a restriction on transfer to comply with the "Pooling-of-Interests Accounting" rules set forth in Accounting Series Release Numbered 130 ((10/5/72) 37 FR 20937; 17 CFR 211.130) and Accounting Series Release Numbered 135 ((1/18/73) 38 FR 1734; 17 CFR 211.135).

(c) EFFECTIVE DATE.—The amendment made by subsection (a) and the provisions of subsection (b) shall apply to taxable years ending after December 31, 1981.

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98TH CONGRESS
1ST SESSION

H. R. 3388

To provide that the provisions of section 252 of the Economic Recovery Tax Act of 1981 (relating to transfers of property to employees subject to certain restrictions) shall apply to certain transfers occurring during 1973.

IN THE HOUSE OF REPRESENTATIVES

JUNE 22, 1983

Mr. MATSUI (for himself, Mr. THOMAS of California, and Mr. FAZIO) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To provide that the provisions of section 252 of the Economic Recovery Tax Act of 1981 (relating to transfers of property to employees subject to certain restrictions) shall apply to certain transfers occurring during 1973.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That—

(a) IN GENERAL.—Notwithstanding subsection (c) of section 252 of the Economic Recovery Tax Act of 1981, the amendment made by subsection (a) of such section 252 (and the provisions of subsection (b) of such section 252) shall apply to any transfer of stock to any person if—

(1) such transfer occurred in November or December of 1973 and was pursuant to the exercise of an option granted in November or December of 1971,

(2) in December 1973 the corporation granting the option was acquired by another corporation in a transaction qualifying as a reorganization under section 368 of the Internal Revenue Code of 1954,

(3) the fair market value (as of July 1, 1974) of the stock received by such person in the reorganization in exchange for the stock transferred to him pursuant to the exercise of such option was less than 50 percent of the fair market value of the stock so received (as of December 4, 1973),

(4) in 1975 or 1976 such person sold substantially all of the stock received in such reorganization, and

(5) such person makes an election under this section at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe.

(b) LIMITATION ON AMOUNT OF BENEFIT.—Subsection (a) shall not apply to transfers with respect to any employee to the extent that the application of subsection (a) with respect to such employee would (but for this subsection) result in a reduction in liability for income tax with respect to such employee for all taxable years in excess of $100,000 (determined without regard to any interest).

(c) STATUTE OF LIMITATIONS.—

(1) OVERPAYMENTS.—If refund or credit of any overpayment of tax resulting from the application of subsection (a) is prevented on the date of the enactment of this Act (or at any time within 6 months after such date of enactment) by the operation of any law or rule of law, refund or credit of such overpayment (to the extent attributable to the application of subsection (a)) may, nevertheless, be made or allowed if claim therefor is filed before the close of such 6-month period.

(2) DEFICIENCIES.—If the assessment of any deficiency of tax resulting from the application of subsection (a) is prevented on the date of the enactment of this Act (or at any time within 6 months after such date of enactment) by the operation of any law or rule of law, assessment of such deficiency (to the extent attributable to the application of subsection (a)) may, nevertheless, be made within such 6-month period.

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97th Congress } HOUSE OF REPRESENTATIVES { Report
1st Session } { No. 97-201

TAX INCENTIVE ACT OF 1981

REPORT

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ON

H.R. 4242

together with

ADDITIONAL, MINORITY, AND ADDITIONAL DISSENTING VIEWS

July 24, 1981.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

2. Property transferred to employees subject to certain restrictions (sec. 810 of the bill and sec. 83 of the Code)

Present Law

Under present law, the taxation of property transferred by an employer to an employee as compensation is governed by section 83.

Generally, if property (including stock) received is not transferable or is subject to a substantial risk of forfeiture (such as the obligation to perform future services), taxation is postponed until the stock or the property is transferable or is no longer subject to a substantial risk of forfeiture. The Tax Court has ruled[1] that section 16(b) of the Securities Exchange Act of 1934, under which an "insider's" profit may be recovered by a corporation if the stock is sold within six months of receipt, does not make the stock nontransferable, and therefore does not affect the taxation of the stock. Thus, the value of the stock (less any amount paid) is treated as compensation when received.

An employer generally is allowed a business expense deduction equal to the amount includible in the employee's income in its corresponding taxable year (sec. 83(h)).

Reasons for Change

The committee believes that the imposition of Federal restrictions, which limit the ability of an "insider" to dispose of stock for a short period of time after receipt, should be taken into account in determining the manner in which the value of the stock should be included in income. Because of mandated restriction on transferability, the committee believes it may be inequitable to tax the employee before the restriction lapses.

Explanation of Provision

Under the provision, a taxpayer who receives stock subject to the application of section 16(b) of the Securities and Exchange Act of 1934 will be treated as being subject to a substantial risk of forfeiture for the 6-month period during which that section applies. Thus, the employee will include in income, and the employer may deduct, at the time the restriction lapses, the difference between the value of the stock at that time and the amount paid for the stock (if any).

A similar rule is applicable if the stock is subject to restriction by reason of the need to comply with the "Pooling-of-Interests Accounting" rules set forth in Accounting Series Release Numbered 130 ((10/5/72) 37 FR 20937; 17 CFR 211.130) and Accounting Series Release Numbered 135 ((1/18/73) 38 FR 1734; CFR 211.135).

Effective Date

The provision will apply to taxable years ending after June 30, 1969. However, for taxable years beginning before January 1, 1982, the provision will apply only if the person receiving the property elects, in accordance with Treasury regulations, to have the provision apply.

Revenue Effect

This provision is estimated to affect revenues by less than $15 million.

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[1] *Horwith v. Comm'r.*, 71 T.C. 932 (1979).

Chairman **Stark**. Mr. Duncan.

Mr. **Duncan**. Thank you, Mr. Morris.

Chairman **Stark**. Thank you, Mr. Morris.

Mr. **Morris**. Thank you very much.

Chairman **Stark**. Mr. Robert J. Frulla, President of Freight Forwarders Institute, testifying on H.R. 3528

STATEMENT OF ROBERT J. FRULLA, PRESIDENT, FREIGHT FORWARDERS INSTITUTE, ACCOMPANIED BY DON EVANS, COUNSEL

Mr. **Frulla**. Thank you, Mr. Chairman and members of the subcommittee, for the opportunity to appear before you concerning H.R. 3528.

My name is Robert J. Frulla. I am president of the Freight Forwarders Institute, a national association of the regulated domestic common carrier freight forwarding industry.

With me is Mr. Don Evans, counsel of the association.

I would like to make a short summarized statement to you today. I have submitted a longer written statement for the record.

Mr. Chairman, the once valuable ICC permits of freight forwarders, like those of motor carriers, have been rendered worthless by deregulation.

The Economic Recovery Tax Act of 1981 clarified existing law by providing a deduction for the devalued operating rights of motor carriers.

The Freight Fowarders Institute requests the committee's support for H.R. 3528, legislation introduced by Representative Kennelly to provide a similar deduction for freight forwarder operating rights.

The legislation is supported by principles of fairness and equity, and by the same sound tax policies underlying the motor carrier legislation.

In some important respects, indeed, the case is more compelling for freight forwarders than it is for motor carriers. In every respect, it is at least as compelling.

First, meaningful ICC entry restriction of freight forwarders has ended. The grant rate has been effectively 100 percent for several years. De facto, administrative deregulation began earlier and ran deeper for freight forwarders than it did for motor carriers.

Second, the statutory entry provisions for freight forwarders are significantly less restrictive, more procompetitive than the governing motor carrier statute.

Third, the Motor Carrier Act of 1980, as interpreted and applied by the Interstate Commerce Commission, has had a profound effect on the regulation of freight forwarders.

Like much of the motor carrier industry and the American trucking associations, many forwarders and the institute have not always agreed with the full extent of the Commission's interpretation of the statute, but it is, nonetheless, a fact of our economic and regulatory life.

In recognition of this fact, the institute has announced its support for legislation, S. 2874, which would formally remove all vestiges of economic regulation of the freight forwarder industry.

From the point of view of tax policy, the critical point is that both motor carriers and freight forwarders, whatever the differences in their regulatory situations, have had their certificates rendered worthless by a fundamental change in governmental entry policy. They should be afforded the same tax treatment. The revenue impact of a tax deduction for freight forwarders is approximately $3 million; small in comparison to the impact of the motor carrier provisions.

The Freight Forwarders Institute requests the committee's support for legislation to give forwarders the same ordinary deduction for their permits as that already provided for the certificates of motor carriers.

Thank you, Mr. Chairman. I would be happy to answer any questions.

[The prepared statement follows:]

STATEMENT OF ROBERT J. FRULLA, PRESIDENT, FREIGHT FORWARDERS INSTITUTE

The once-valuable ICC permits of freight forwarders, like those of motor carriers, have been rendered worthless by deregulation. The Economic Recovery Tax Act of 1981 clarified existing law by providing a deduction for the devalued operating rights of motor carriers. The Freight Forwarders Institute requests the Committee's support for H.R. 3528, legislation introduced by Rep. Kennelly to provide a similar deduction for freight forwarder operating rights. The legislation is supported by principles of fairness and equity—and by the same sound tax policies underlying the motor carrier legislation.

In some important respects, indeed, the case is more compelling for freight forwarders that it is for motor carriers. In every respect, it is at least as compelling.

1. Meaningful ICC entry restriction of freight forwarders has ended. The grant rate has been effectively 100 percent for several years. De facto, administrative deregulation began earlier and run deeper for freight forwarders than it did for motor carriers.

2. The statutory entry provisions for freight forwarders are significantly less restrictive, more pro-competitive, than the governing motor carrier statute.

3. The Motor Carrier Act of 1980, as interpreted and applied by the Interstate Commerce Commission, has had a profound effect on the regulation of freight forwarders. Like much of the motor carrier industry and the American Trucking Associations, many forwarders and the Institute have not always agreed with the full extent of the Commission's interpretation of the statute, but it is nonetheless a fact of our economic and regulatory life. In recognition of this fact, the Institute has announced its support for legislation (S. 2874) which would formally remove all vestiges of economic regulation of the freight forwarder industry.

From the point of view of tax policy, the critical point is that both motor carriers and freight forwarders, whatever the differences in their regulatory situations, have had their certificates rendered worthless by a fundamental change in governmental entry policy. They shoud be afforded the same tax treatment. The revenue impact of a tax deduction for freight forwarders is approximately 3 million dollars—small in comparison to the impact of the motor carrier provisions. The Freight Forwarders Institute requests the Committee's support for legislation to give forwarders the same ordinary deduction for their permits as that already provided for the certificates of motor carriers.

STATEMENT

Thank you Mr. Chairman and members of the Subcommittee for the opportunity to appear before you concerning H.R. 3528. I appear to request on behalf of the Freight Forwarders Institute that the sound principles underlying the deduction for motor carrier operating rights also be applied to freight forwarders.

My name is Robert J. Frulla. I am President of the Freight Forwarders Institute, a national association of the regulated, domestic, common-carrier freight forwarding industry.

Though perhaps less well recognized than other common carriers, freight forwarders are an integral part of our surface freight transportation system. A forwarder takes freight from shippers, usually in small shipments, combines it with freight of other shippers, and sends it on its way via some other carrier, usually a motor common or contract carrier. Forwarders are, on the one hand, closely integrated with motor carrier operations, and, on the other hand, meet motor carriers in head to head competition.

Mr. Chairman, we appear before you today to request equitable tax treatment for freight forwarders. Like motor carriers, freight forwarders have had their once-valuable ICC permits rendered worthless by deregulation. The Economic Recovery Tax Act of 1981 correctly and justifiably clarified existing law to permit motor carriers a deduction for their worthless certificates. The Freight Forwarders Institute seeks the support of the Subcommittee on Select Revenue Measures, and the Committee on Ways and Means, for legislation which would provide the same tax treatment for freight forwarders' permits. It is supported by the same sound tax policy which underlies the statutory provision allowing a deduction for motor carrier operating rights.

Indeed, in many significant respects, the case for such a provision for freight forwarders is even stronger than the case for motor carriers. In every significant respect, it is at least as strong. Let me put the point slightly differently: While there are differences in the regulatory status of freight forwarders and motor carriers, there exists no difference which justifies, from the point of view of sound tax policy, differing tax treatment of their worthless certificates.

I wish to make three basic points with respect to the deregulation of freight forwarders: (1) meaningful entry restriction no longer exists; (2) the existing statutory entry standards applicable to freight forwarders are even less restrictive than the motor carrier criteria, and (3) the Motor Carrier Act of 1980, as interpreted by the Interstate Commerce Commission, has had a profound impact on the regulation of freight forwarders.

1. Meaningful entry restriction no longer exists for freight forwarders. For an ICC license to have significant value, it must represent a "scarce" commodity and it must create some benefit in terms of exclusion of competition. The ICC entry policy relating to it must meaningfully limit the number of competitors that can be licensed and thus meaningfully limit the competition the licensee faces. Entry policy administered by the Commission has ceased serving that function for freight forwarders just as it has for motor carriers.

I know of no knowledgeable person who contests the proposition. Indeed, it is even more clearly the case for freight forwarders than for motor carriers.

The numbers are the best evidence. Attached to this testimony as "Exhibit A" is a chart setting out in detail the freight forwarder grant rate for the years 1958 through 1967, and the years 1977 through August 31, 1983. (The Commission stopped keeping these statistics in 1967 and did not begin again until they computerized in 1977.) What these numbers show is a grant rate of effectively 100 percent at least since 1977. And, they further show, as the word spread in the transportation industry, a steadily growing number of applications. Since passage of the Motor Carrier Act in 1980 through the end of the period of our study (August 31, 1983), out of a total of 296 applications, only 9 have been denied "on the merits." We have examined those nine cases listed in Commission statistics as denials. Two of them are actually grants, with the grant coming on appeal of the initial negative decision.[1] Three were denied because the applicant already held authority as a common carrier, contract carrier or licensed broker.[2] The other four denials, all by employee review boards, were based upon the applicant's failure to make a significant showing of proposed operations or shipper support to make even a prima facie showing of public need.[3] There exists no significant restriction of freight forwarder entry.

"Exhibit B" to my testimony sets out the moto carrier grant rate since 1976. An examination of that chart reveals that the motor carrier grant rate on the merits did not become effectively 100 percent until 1979 or 1980—at least several years after the doors were thrown wide open to forwarder applicants.

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[1] Imperial Carriers, Inc. Extension—Nationwide General Commodities, No. FF-416 (Sub-No. 3) (served Apr. 28, 1982) (granted in decision served July 29, 1982); U.S. Express, Inc., Freight Forwarder Application, No. FF-578 (served Mar. 8, 1982) (granted in decision served May 17, 1982).

[2] Slay Transportation Co., Inc., Freight Forwarder Application, No. FF-625 (served Mar. 14, 1983); APX International, Inc., Freight Forwarder Application, No. FF-580 (Sub-No. 1) (served Aug. 3, 1982); and Cosmopolitan Forwarders, Ltd., Freight Forwarder Application, No. FF-551 (served Aug. 18, 1981).

[3] Airborne Forwarding Corporation Extension—United States, No. FF-392 (Sub-No. 4) (served May 26, 1982); Atlas Consolidated Container, Inc., Freight Forwarder Application, No. FF-573 (served Feb. 26, 1982); CTC Forwarding Company, Inc., Freight Forwarder Application, No. FF-555 (served Nov. 17, 1981); and Bonney Forwarding, Inc., Freight Forwarder Application, No. FF-549 (served Aug. 19, 1981).

The open entry policy regarding forwarder permits of the last seven years contrasts with the severely restrictive policy exercised during the 1958 to 1967 period, as shown in the chart. During that period, the grant rate on the merits averaged

trasts with the severely restrictive policy exercised during the 1958 to 1967 period, as shown in the chart. During that period, the grant rate on the merits averaged

about 60 percent, and the average number of applications per year was only 15, compared to an average of 60 applications for the years since 1977. The low grant rate and low number of applications from 1958 to 1967 reflect the importance placed by the Commission during the period upon the factor of "adequacy of existing service," i.e., protection of existing competitors, in deciding on forwarder applications. A clear statement of this philosophy is contained in *Frank P. Dow Co., Inc., Extension—Longview*, No. FF-173 (Sub No. 1), 16 CCH Federal Carrier Cases ¶ 35, 711 (January 13, 1964). See also D.C. Andrews & Co. of Illinois, Inc. Extension—Baltimore Maryland, No. FF-36 (Sub No. 3), 1966-67 CCH Federal Carrier Cases ¶ 36,032 (July 21, 1966); *H.E. Sutton Freight Forwarder Application*, No. FF-323, 1966-67 CCH Federal Carrier Cases ¶ 36, 139 (September 18, 1967); *New England Forwarding Co. Extension, Import Export*, No. FF-96 (Sub No. 2), 1968-1970 CCH Federal Carrier Cases ¶ 36,317 (May 17, 1968); *Acme Fast Freight, Inc.* v. *United States*, 1968-1970 CCH Federal Carrier Cases ¶ 81,973 (December 10, 1967).

In the 1970's, the ICC began slowly and steadily deregulating. Deregulation of forwarders moved at a faster pace than that of motor carriers. The main reason for this was that the forwarder entry criteria were inherently less restrictive than the motor carrier entry criteria. The ICC had recognized as early as 1966 that the "public interest" test applicable to freight forwarders was more liberal than the "public convenience and necessity" test applicable to motor carriers. *D.C. Andrews & Company of Illinois, Inc., Extension—Baltimore Md.*, supra. Beginning in approximately 1973, the Commission increasingly began to emphasize this point and, correspondingly, began to downplay the importance of protecting existing competitors. The Commission's approach, and its underlying interpretation of the statute, were confirmed by the courts. See, e.g., Yellow Forwarding Co. v. United States, 1973-76 CCH Federal Carrier Cases ¶ 82,464 (D. Kan. 1973); *Aloha Consolidators International v. United States*, 1973-76 CCH Federal Carrier Cases ¶ 82,583 (D. Col. 1975). The explicit relaxation of entry standards was steady and progressive. As will be discussed at a later point in my testimony, the year 1980, with the passage of the pro-competive Motor Carrier Act, marked its culmination.

Freight forwarder permits are worthless for the same reason motor carrier certificates are: The Commission no longer meaningfully restricts entry. Moreover, with respect to freight forwarders that fact is clearer, and longer-established, than it is with respect to motor carriers—and even for motor carriers it is very clear and very well established.

2. The statutory entry criteria applicable to freight forwarders, which are virtually identical to the recently-enacted bus criteria, are more liberal than the motor carrier criteria. The Commission's open-entry policy for freight forwarders is, as indicated in the foregoing portion of my testimony, solidly tied to the relevant statutory criteria. It has been endorsed by the courts. It has been sealed and solidified by the pro-competitive Motor Carrier Act of 1980. It has produced a flood of new competitors for freight forwarders. There can be no turning back. Not all of our members may like that, but we are resigned to it. It is a fact of our economic and business life. *Re*regulation of either motor carriers or freight fowarders, so as to restore value to their certificates, is not a realistic possibility, and this is even more clearly the case for forwarders than for motor carriers. That is one of the principal reasons the Institute has announced its support for legislation formally ending all economic regulation.

Freight forwarder entry is governed by a "consistent with the public interest" standard. 49 U.S.C.A. § 10923(a)(2) (West Supp. 1983). As related above, this standard has been definitively interpreted by the Commission and the courts to place much less importance on considerations of protecting existing competitors than the traditional "public convenience and necessity" test applicable to motor carrier licensing. Indeed, in enacting the pro-competitive Bus Regulatory Reform Act of 1982, Congress adopted the "consistent with the public interest" standard (49 U.S.C.A. § 10922(c)(1)(A) (West Supp. 1983)), explicitly noting that this standard is less restrictive than the criteria applicable to motor carriers under the Motor Carrier Act of 1980. S. Rep. No. 411, 97th Cong., 2d Sess. 15, reprinted in 1982 U.S. Code Cong. & Ad. News 2308, 2322.

The entry policy which rendered truck certificates worthless was dependent, to some critical extent, on the Commission's application and interpretation of the relevant statutues, informed by the general pro-competitive national transportation policy declared by Congress. Standing alone, the statutory provisions do not mandate the full extent of the open-entry policy. The Motor Carrier Act of 1980 left in place some formal entry requirements for motor carriers. The certificates are, nonetheless, worthless.

The same is true for freight forwarders. Commission interpretation and applica-

theless, worthless.

The same is true for freight forwarders. Commission interpretation and application, confirmed by the courts, necessarily plays a role. The statute does not end the matter. Forwarders, like motor carriers, have had their permits rendered worthless by the ICC, a creature of Congress acting pursuant to a Congressional delegation of authority. The process will not be reversed. However, if one were to argue that it could be reversed, even theoretically, one would also have to admit that, on the basis of the relevant statutory provisions, it could be reversed even more easily for motor carriers.

3. The Motor Carrier Act of 1980, as interpreted by the Interstate Commerce Commission, has had a profound effect upon freight forwarder regulation. The Act did not amend the entry criteria applicable to freight forwarders. It did not have to. The existing criteria, as discussed in the previous portion of my testimony, were already more liberal than the criteria which the Motor Carrier Act put in place for motor carriers of property.

The most basic way in which the Act furthered freight forwarder deregulation was by establishing the fundamental procompetitive national transportation policy by which the remaining regulation of the motor carrier industry, and the integrally related freight forwarder industry, was to be conducted.

Indeed, in the Freight Forwarders Institute's view, the Commission has gone to unreasonable lengths in taking specific provisions of the Act which, by their terms, apply only to motor carriers and applying them wholesale to forwarders. The clearest case in point concerns the restriction removal provisions of the Act. Even though the special procedures and relaxed standards for restriction removal of the Act apply only to motor carriers, the Commission, in Ex Parte No. 142 (Sub. No. 2), decided to make them applicable to freight forwarders as well. In the course of its decision the Commission cited its traditional "policy of parity in treatment of these two types of regulated entities," "the close operational relationship between motor carriers and freight forwarders," the Act's pro-competitive changes in the National Transportation Policy, its intent to encourage intermodalism, and its setting of the deregulatory "tone" for the regulatory structure. The U.S. Court of Appeals for the Fifth Circuit held that the Commission cannot take so specific a section of the statute and apply it wholesale to forwarders without Congressional authorization. *Global Van Lines, Inc.* v. *ICC*, 714 F.2d 1290 (5th Cir. 1983). But that is not the point. Whether or not the Commission can go this far in a specific area, Ex Parte No. MC-142 (Sub. No. 2) and the reasoning on which it is based are vivid examples of the pervasive effect of the Motor Carrier Act of 1980 on forwarder regulation. Whether or not the Commission can adopt the Act's specific restriction removal rules for direct application to freight forwarders, it can and has applied the Act's deregulatory thrust to its freight forwarder entry decisions in particular and to its regulation of forwarders in general.

Another important, fundamental, point needs to be made concerning the impact of the Act on freight forwarders. While freight forwarders cooperate closely with motor carriers in providing service, we are also directly in competition with motor carriers. We offer the same service to shippers, particularly with respect to small shipments, as the L-T-L carriers of general commodities do. The mere fact of motor carrier entry liberalization, apart from freight forwarder entry liberalization, dramatically reduced the worth of our permits. Liberal motor carrier entry itself has confronted us with more, and bigger, competitors.

The Motor Carrier Act of 1980, as interpreted by the Interstate Commerce Commission, to repeat my basic and important point, has had a profound and pervasive effect on freight forwarders.

Mr. Chairman, before closing, let me briefly address some of the more narrow "tax" aspects of our proposed legislation. We break no new ground here. H.R. 3528 is identical in all important respects with the previously enacted motor carrier provision. Like that statute, H.R. 3528 provides for a 60-month amortization period for the deduction. I should note that this proposal, like the motor carrier provision, begins the amortization period on July 1, 1980, the date of passage of the Motor Carrier Act. As explained above, it was on this date that the worthlessness of freight forwarder permits was definitively established.

We estimate the revenue impact to be a maximum of $3 million. This is certainly small in comparison even to the modest impact of the motor carrier provision. Indeed, as was the situation with motor carriers, it is arguable that existing law, apart from the statutory provisions, allows a deduction for the worthless rights. The proposed legislation would clarify the law and avoid costly and wasteful litigation. Under this view, there would be no negative revenue impact.

Mr. Chairman, I urgently request the support of this Subcommittee and the support of the Ways and Means Committee for H.R. 3528. The legislation is supported by sound tax policy. Moreover, to fail to afford freight forwarders the same treatment as motor carriers would be, in our sincerely-held view, inequitable and unfair.

by sound tax policy. Moreover, to fail to afford freight forwarders the same treat-

EXHIBIT A.—GRANT RATE ON FREIGHT FORWARDER APPLICATIONS

Fiscal year	Total	Granted	Denied	Dismissed withdrawn, not decided	Total grant rate (percent)	Grant rate on merits (percent)
1958	4	2	0	2	50	100
1959	2	1	1	0	50	50
1960	39	5	2	32	13	71
1961	15	3	1	11	20	75
1962	14	8	3	3	57	73
1963	8	4	3	1	50	57
1964	14	7	2	5	50	78
1965	14	6	4	4	43	60
1966	17	4	7	6	24	36
1967	21	10	9	2	48	53
Weighted average						61

The ICC discontinued reporting freight forwarder grant rate statistics in 1967. The information is not again available until 1977, when the ICC began to keep its statistics on computer.

Calendar year	Total	Granted	Denied	Dismissed, withdrawn, not decided	Total grant rate (percent)	Grant rate on merits (percent)
1977	54	52	1	1	96	98
1978	25	20	2	3	80	91
1979	16	12	2	2	75	86
1980	34	31		3	91	100
1981	71	58	3	10	82	95
1982	99	79	5	15	80	94
1983 [1]	92	82	1	9	89	99
Weighted average						96

[1] To Aug. 31, 1983.

EXHIBIT B.—GRANT RATE ON MOTOR CARRIER APPLICATIONS

Fiscal year	Total	Granted	Denied	Dismissed, withdrawn, not decided	Total grant rate (percent)	Grant rate on merits (percent)
1977	7,848	6,038	984	826	77.0	86.0
1978	9,767	8,684	384	699	88.9	95.8
1979	12,944	12,233	200	511	94.5	98.4
1980	22,735	22,125	97	513	97.4	99.6
1981	28,414	27,475	231	708	96.7	99.2
1982	15,553	14,786	147	620	95.1	99.0
1983 [1]	6,646	6,323	24	299	95.1	99.6
Weighted average						97.9

[1] To Apr. 1, 1983.

Chairman **Stark**. Well, I guess the only question—I should have asked this of the trucking folks. I always suspected a variety of the industry—railroads, airlines, the trucking industry—are going to come back and ask us to regulate them again.

If that were the case, would you promise me you would not want to come back and recapitalize—*if in the event you* asked to be regulated once again, then you will put those certificates on your balance sheet value, OK?

Mr. FRU Yes, sir, I promise you that, sir.

Chairma RK. Mr. Duncan.

Mr. DUN I have no questions. I thank you for being here.

Chairma RK. Thank you, gentlemen.

Mr. Scog I notice, is still here. Is Mr. Odegard, Mr. Cain and Mr. Graha the audience? If they are here, we will take you one at a ti o you want to wait, Mr. Scoggins, or get your testimony on th ord?

Mr. SCOG I would just as soon proceed, Mr. Chairman.

Chairma RK. Come right ahead.

Just for hair's information, is Mr. Lopeman in the room?

You are ing now on H.R. 4167 and——

Mr. SCOG H.R. 4779.

Chairma RK. We did H.R. 5922 earlier this morning, is that correct?

Mr. SCOG I believe that was a misprint. It should have been 5022.

Chairma RK. OK. We have your prepared statement which will appear e record. You may proceed.

STATEMENT H.B. SCOGGINS, JR., GENERAL COUNSEL, AND VICE PR NT, GOVERNMENT RELATIONS, INDEPENDENT PETROLE SSOCIATION OF AMERICA

Mr. SCOG Thank you, Mr. Chairman. I will be very brief and just make s eneral observations.

On H.R. concerning unrelated business income, you have already hea timony on other bills this morning related to the unrelated b s income issue.

This is a r problem, but somewhat different.

The crux e issue here is that an exempt organization, such as educatio stitutions and pension funds can invest now in oil and gas op ns, in nonworking interest type arrangements, either throu ning royalty or holding production payments.

They are axed as unrelated business income. However, if they hold king interest, it is taxed as unrelated business income. The ally is no distinction as far as the economic reality as to wheth s a working or nonworking interest.

Income to organization is still from the same source, the production of oil and natural gas, and the thrust of this bill would simp to recognize the economic reality that these exempt orga ions can and do now invest in oil and gas operations, but t re limited in the way in which they can do it because of the nt provisions.

Chairman K. Could I just ask this: It often puzzles me. In theory I thi gree with you. Isn't there some way—the oil industry, and arned counsel, and CPA's are pretty creative—isn't there way they could get from A to B without legislation? Couldn y structure some kind of a hybrid agreement that would get them the same economic income—if they are tax free, the tax exemptions are not as important to them.

I just wonder why legislation and why they just could not work out a kind of hybrid kind of conditional royalty contract or something else that would end up being the same thing as a working interest.

Mr. SCOGGINS. A considerable amount of time and effort has been devoted to that, as you might imagine. Thus far they have not been able to satisfy the IRS. I don't think there would be any revenue impact whatsoever to this provision. It simply would give these organizations more flexibility in how they manage their endowments and their pension trusts and these type of funds and create greater opportunity for them.

It also would provide additional sources of much needed capital for investment in exploration and drilling operations which we presently don't have.

That will conclude my testimony on that bill, unless there are other questions.

[The prepared statement follows:]

STATEMENT OF H. B. SCOGGINS, JR., GENERAL COUNSEL, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

The Independent Petroleum Association of America is a national organization of some 7,000 independent oil and natural gas producers in every producing area of the United States. IPAA, together with the twenty-nine unaffiliated associations listed on the cover page, represents virtually all independent producers and thousands of royalty owners in the United States. We are grateful for this opportunity to present our views in support of H.R. 4167 to update the definition of unrelated business taxable income in connection with the hearings held by this subcommittee on October 3, 1984. We respectfully request that this statement be made a part of the permanent record of that hearing.

In general, the statute now provides that a tax exempt organization is subject to tax at the regular corporate rates on income derived from the active conduct of a trade or business which is not substantially related to the function or purpose upon which the tax exemption is based. These provisions were adopted principally to eliminate a competitive advantage a tax exempt organization would have compared to a taxable entity engaged in the same business. The statutes distinguish income derived from a "trade or business," which is taxable and income derived from investments, which is not taxable. Therefore, income received from interest, dividends, rents or royalties does not affect the tax of the organization except in special situations. In order for the unrelated business tax to be imposed, the exempt organization must be regularly engaged in unrelated activities which constitute a trade or business such as the offering of goods for sale or the performance of services. Where an exempt organization is a member of a partnership, the law currently provides that the partner will receive unrelated business income equal to its share of the income derived from any unrelated business activity conducted by the partnership.

Interests in oil and gas properties may be held by an exempt organization in two general forms. The entity may acquire a "nonoperating interest," that is, a right to the reserves in place which is not required to bear a proportionate share of the costs of exploration, development or production. These nonoperating interests commonly take the form of royalties, net profit interests or, in limited circumstances, a production payment. The income derived from these interests is not "trade or business" income and is therefore not subject to the unrelated business tax. Oil and gas reserves may also be acquired through an "operating interest," or an interest which shares in the costs of exploration, development and production. These interests are commonly referred to as working interests and unlike a royalty or similar interest, the participation in costs of development and production place the owner in a "trade or business." This determination is not affected by the nature of the activity actually performed by the interest owner. The working interest owner is engaged in a "trade or business" even where the day to day operation of the property is delegated to a third party operator. Thus it is the nature of the interest in the property and not the activities with respect to the property which determines the existence of a "trade or business."

The bill currently before the subcommittee, H.R. 4167, would amend the definition of unrelated business taxable income to exclude working interests held through certain limited partnerships for pension trusts and educational organizations. These provisions would provide needed flexibility to the investment managers of pension funds, individual retirement accounts (IRA) and endowments by enabling them to diversify their portfolios. The bill would also make available a new source of funds to the oil and gas industry which is chronically short of investment capital. Provisions which achieve such desirable policy goals in a manner which is essentially revenue neutral, should not be rejected unless the negative potential is both clear and persuasive. The arguments presented against the provisions appear to be neither.

H.R. 4167 acknowledges the economic fact that a net profits interest is substantially equivalent to a limited partnership interest in a limited partnership owning an undivided working interest. In either case, the investor's capital investment is limited to the amount initially contributed to the investment. Income from the net profits interest, however, is not considered unrelated business income while income from the limited partnership interest is considered to be unrelated business income. The essential economic similarity of these types of investments does not support disparate income tax treatment. Limited partnerships owning working interest in oil and gas properties have become the standard vehicle to raise equity capital in the market place. This structure has become widespread primarily because it is simpler to negotiate exploration and development activities with industry partners when all parties, including a limited partnership co-owner, have a full working interest in the properties subject to the joint venture agreement.

The principal argument against H.R. 4167 is that it is inconsistent with the theory of the unrelated business tax and that creating an exemption for certain oil and gas limited partnerships will lead to similar treatment for all business activity conducted by limited partnerships. These arguments are clearly strained. The "theory" of the unrelated business tax is to prevent exempt entities from using their exempt status to gain a competitive advantage. An exempt organization which holds a limited partnership interest in a partnership holding working interests has no greater or lesser competitive advantage than if it held the same interest in the form of a royalty or net profits interest. In both situations, the essential source of income is the sale of the production and this function is not affected by the nature of the economic interest held by the exempt entity. The provisions of H.R. 4167 simply allow exempt entities to acquire ownership of oil and gas reserves in a direct, straightforward manner without placing unwarranted emphasis on the legal nature of the economic interest acquired.

Concerns that the treatment of oil and gas limited partnerships proposed in this legislation will ultimately extend to other limited partnerships do not appear valid. Although Congress has chosen to treat all limited partnership income as "passive" for individuals (the limited business interest provisions of section 55 IRC for purposes of the alternative minimum tax) concerns over the future direction of policy are not appropriate reasons to object to these provisions.

It is also argued that the unique risks of oil and gas investments make this investment inappropriate for institutions such as pension trusts and educational endowments. It is without question that the exploration and development of oil and gas reserves involve great risk. As a result, they are not appropriate investments for those without knowledge and experience in evaluating these investments. The provisions of H.R. 4167, however, do not create new opportunity for exempt entities to expose themselves to risk; the provisions of the bill simply add flexibility to those investments. Exempt organizations, guided by prudent investment advice, can and do now make investments in oil and gas either through royalty interests or through the ownership of stock in producing companies. Depending upon the stage of development, the risk in these investments is just as great as in acquiring a working interest. We would not, however, seek to preclude these investments because of risk, but only require that they be guided by the standards of prudent judgment.

It has also been stated in opposition to the bill that there are not sufficient limitations on partnership allocations to prevent the transfer of tax benefits from tax exempt partners to taxable partners. When viewed in context of the existing statutory and regulatory framework, we believe these concerns are overstated. The provisions of the bill when combined with the provisions of section 704, regarding substantial economic effect in partnership allocations, and section 613A, determining basis for depletion, provide a solid basis for denying tax benefits in cases of perceived abuse. To determine the potential for abuse, the entire structure of the Internal Revenue Code must be considered, not just this isolated amendment.

In summary, we believe that H.R. 4167 would provide flexibility to institutions and much needed capital to the oil and gas industry with little or no cost to the Treasury. The benefits to be derived from these provisions by both the institutions and the oil and gas industry are obvious, while opposition to the provisions is strained and highly subjective. The provisions of H.R. 4167 represents a well balanced approach to allow institutions to directly acquire interests which they can now acquire only indirectly. The provisions of the bill are a straightforward attempt to update the definition of unrelated business taxable income to reflect current business realities and should be enacted.

Chairman STARK. OK.

Mr. Duncan, do you have any questions on that?

Mr. DUNCAN. I have no questions other than to thank Mr. Scoggins. I have said a number of times that your association always does, I think, make one of the best presentations to this committee. You are always prepared.

Mr. Chairman, I have a letter that Mr. Campbell would like to be made a part of the record. It is from the president of the University of South Carolina.

Chairman STARK. Without objection, the letter will be included.

[The letter appears in the appendix.]

Chairman STARK. Do you have testimony on a second bill?

Mr. SCOGGINS. H.R. 4779.

Chairman STARK. Proceed.

Mr. SCOGGINS. You heard earlier this morning from Mr. Thomas, the principal sponsor of that bill. It concerns the exemption from the windfall profit tax for an amount of crude oil exchanged for fuel oil to be used to fire boilers to create steam for enhancement recovery projects, primarily within the State of California.

The Treasury is in support of the bill and indicated that it was simply an oversight in the drafting of the windfall profit tax legislation originally that created this problem.

I don't believe there is any need to elaborate on that any further except to indicate that most of the larger producers have been able to make arrangements to burn crude oil and avoid the windfall tax, because they have been able to finance the installation of scrubbers to meet the environmental restraints.

Many of the smaller producers just cannot afford the initial capital outlay. These installations cost up to $2 million for installation and can cost as much as $600,000 per year just for operation of the scrubbers on one of these steam generator plants.

Consequently, many of the properties owned by the smaller independents are having to be plugged and abandoned prematurely because of the uneconomic situation.

I do have some additional data which we received just this morning and were not able to include in our statement for the record. I would like permission to submit it.

Chairman STARK. Without objection, we would be glad to have it for the record.

Mr. SCOGGINS. I would be glad to answer any questions about that.

Chairman STARK. Mr. Duncan.

Mr. DUNCAN. I have no questions.

Chairman STARK. I have none either.

Thank you, Mr. Scoggins.

Do we have any other witnesses in the room? I will be glad to take them out of order now.

Nobody here to testify on anything at all. You want to introduce any new bills while you are here?

The committee will recess until 2 o'cock or 30 minutes after the vote on the issue being debated now.

If there is a vote on the floor, we will reconvene 30 minutes after that. Otherwise, at 2 o'clock.

[Whereupon, at 1:15 p.m., the subcommittee was recessed, to reconvene at 2 p.m]

AFTERNOON SESSION

Chairman STARK. The committee will resume.

We will call Father Paschal Phillips, Brother Wollman, Brother or Mr. Stevenson, John Huffaker and Leonard Jensen, counsel for the organizations represented by the witnesses to testify on the bill H.R. 4507. And I wanted to bring the regards of Congressman Foley to his friends from the State of Washington.

He has been quite busy on the floor of the House debating a rather contentious amendment and was unable to be here and he asked me to send his regards.

He is the author of this bill and I was proud to cosponsor it, as a matter of fact, at the request of former Governor Jerry Brown of the State of California.

You may proceed in whatever manner. I think we have prepared statements—not only prepared statements, we have prepared sweets and goodies for which I thank you.

If you would like to summarize your statement as best you can, you may start in any order that you are comfortable.

STATEMENT OF JOHN B. HUFFAKER, COUNSEL, ORDER OF THE CISTERCIANS OF THE STRICT OBSERVANCE, COMMUNITIES OF HUTTERIAN BRETHREN IN WASHINGTON STATE, AND COMMUNITIES OF THE SOCIETY OF BROTHERS

Mr. HUFFAKER. Thank you, Mr. Chairman.

We appreciate being here. I am John Huffaker, acting as counsel. With me is cocounsel, Leonard Jensen.

This bill is sponsored by three groups of religious communities. We have the Hutterian Brethren of the State of Washington who are represented by Jake Wollman; the Order of the Cistercians of the Strict Observance, better known as Trappist, represented by Father Phillips.

Father Phillips is from Oregon. Mr. Wollman is from Washington. Then the Society of Brothers represented by Alan Stevenson, of Connecticut.

We are very pleased that we have as a sponsor or cosponsor each of the States in which we have a community, and as you know, Mr. Chairman, one of the largest of the Trappist monasteries is in the State of California.

We felt the Treasury did a very fair job of summarizing the purpose of the bill. These religious communities do not pay tax on their business income, but the business income is all taxed to the members of the community.

In that way it is very much like a partnership or a subchapter S corporation. For years many people thought that because they were required to file partnership tax returns, the provision for partnerships passing the investment credit through to the partners applied to them also.

However, the ninth circuit in the *Kleinsasser* decision, a little over 1 year ago, held that "Reluctantly we affirm. While we see no legislative purpose being served, nevertheless only Congress can provide for the pass through."

So, therefore, we have designed a bill working closely with the staff that is constructed to permit the pass through. It is so constructed to produce minimum administrative problems, and we do have one staff amendment that—or one amendment to offer that we have discussed with the staff that would restrict the bill to those religious communities in which all persons enjoy substantially the same standard of living.

Now, Mr. Chairman, I want each of the community representatives to explain briefly to you what his community does and as you listen think of the Treasury's objection, the Treasury had two objections.

In the first place, they said this might lead to grant of other credits. I want to assure this committee that we do not see any other credits that are either important or really relevant.

Second, they said it would give a competitive advantage. We think we presently suffer from a disadvantage because all other taxpayers who make these investments get the investment credit.

I would like Mr. Wollman, in not more than 4 minutes, to summarize the situation in the Warden community of the Hutterian Brethren.

[The prepared statement follows:]

STATEMENT OF JOHN B. HUFFAKER, COUNSEL, COMMUNITIES OF HUTTERIAN BRETHREN IN WASHINGTON STATE, ORDER OF THE CISTERCIANS OF THE STRICT OBSERVANCE, AND THE COMMUNITIES OF THE SOCIETY OF BROTHERS

This statement is submitted by John B. Huffaker and Scott B. Lukins as counsel for the following groups: Communities of Hutterian Brethren in Washington State, the Communities of The Order of the Cistercians of the Strict Observance that are described in Section 501(d), and the Communities of the Society of Brothers. Members of each of these groups will appear with the panel at the hearing in order to explain how their communities are conducted and to answer any other questions.

Religious communities that elect pursuant to Section 501(d) are not taxed on the income, but the members must report each one's pro rata share of the income as a dividend. Each community is required to maintain a community treasury and as a practical matter the members living in the community actually handle very little cash. Although it is not a requirement of the statute, the members of the communities for whom this statement is submitted are all subject to a vow of poverty. All the corporations are membership corporations, so that the member does not own a fractional interest of the community property.

The predecessor of Section 501(d) was enacted about 50 years ago to provide for a special rule for the taxation of those religious communities that were not entitled to income tax exemption under the existing law, because the community conducts a business that supports the community and, if possible, produces an excess that can be used to further the charitable and religious purposes of the community. Section 501(d) is remarkable for the long time that it has been in the Code and the lack of litigation that has surrounded its application. We are informed by the Internal Revenue Service that there are currently about 75 organizations in the United States that have elected under Section 501(d). In many ways Section 501(d) was a very simple form of Subchapter S for membership corporations. It was passed before the investment credit, and it was entirely proper to merely provide for the pass through of the income. Interestingly there is no provision for pass through of losses or numerous other provisions that complicate the rules for Subchapter S for participants.

When the investment credit was introduced provision was made for the pass through of the credit from a partnership to a partner, from a trust to the beneficiary and from an S corporation to the shareholders. We believe that the failure to cover the members of an electing religious community was an oversight easily understandable in view of the small number of communities involved and their relatively small size.

The regulations have for many years required the organization to file a partnership return. Since this return provides for the pass through of investment credit, many communities assumed that this also applied to them. However, the Internal Revenue Service and the Ninth Circuit disagreed. The opinion in *Kleinsasser*, 707 F.2d 1024 (9th Cir., 1983), states:

"Reluctantly, we affirm.

"Our conclusion from this brief statutory exegesis is that the exclusion of § 501(d) organizations from the tax credit offered by § 38(a) does not seem to advance any articulated legislative purpose. But it is equally clear that there is nothing in the legislative record to suggest that Congress meant to exempt § 501(d) organizations from the sweep of § 48(a)(4). The lack of clear contrary legislative intent gives us no choice but to enforce the plain language of the statute.

"We cannot put an equitable gloss on the clear language of the Internal Revenue Code. The statutory inequity involved in this case, if there is one, may only be remedied by Congress. We realize that, in light of the Hutterites' religiously based abstention from secular politics, it may ring hollow to advise the members of Milford Colony to go to Congress for relief. But it is from that body alone that relief is available."

This legislative effort is a response to the suggestion by the Court that Congressional relief is appropriate.

The economic activity of each of the three groups is one that would require investments that would qualify for the investment credit if made by any other organization, the income of which is taxed either to the organization or by reason of pass through provisions to others.

The Hutterian Brethren of Washington live in four communities. Their economic activity is farming. Both the raising of potatoes and wheat require large investments in farm machinery.

Three communities of the Order of the Cistercians of the Strict Observance have made the election under § 501(d). The Cistercians are better known as Trappists. Each of the three communities conducts an economic activity that is designed to support the community. The community at Red Bluff, California raises nuts and dates. The community at Lafayette, Oregon farms and binds books as well as making fruitcakes. The community at Trappist, Kentucky, makes cheese and fruitcakes, as well as farming.

The three communities of the Hutterian Society of Brethren engage in an integrated economic activity. For over 25 years they have manufactured and sold playthings for use in kindergartens, nursery schools, and the like. More recently they have begun manufacturing special tables, chairs, and other special devices for use by the handicapped. One community is in New York, near Kingston, one in Connecticut, near Norfolk and one in Pennsylvania, near Scottsdale.

These communities share several important characteristics. (1) The members of each are united by a common religious philosophy and desire to witness their faith by living in community. Each of the communities is relatively secluded, and the community lives apart. (2) The comment to the community is generally a life-long commitment. The membership is very stable. (3) The members live a very simple life that is shared by all the members. (4) Each community seeks not only to support itself, but makes an effort to create an excess that can be used for charitable and religious purposes. The community does not want to be dependent on the charity of others. The work is carried on in the community using the services of the community members as much as possible.

H.R. 4507 was drafted with the assistance of the staff of this subcommittee. We are pleased that the chairman, and Mrs. Kennelly and Mr. Schulze are co-sponsors to the bill introduced by Mr. Foley. In addition, Mr. Rangel and Mr. Boland are cosponsors. Communities that are supporting this legislation are located in the states of each of the sponsors and the cosponsors.

In our discussions with tax specialists we have found that not many have any experience with § 501(d). At a meeting of the American Bar Association Tax Section Committee on Tax Exempt Organizations this proposal was discussed and we found a necessity to introduce even these specialists to this problem, but at the conclusion, an overwhelming endorsement of the bill was given by the committee. We perceive no legislative policy for not allowing the credit to be claimed by the members since they are being taxed on the income.

TECHNICAL DESCRIPTION

The bill proposes to add new Subsection 48(r). Section 48 contains the special rules for investment credit property. Generally it provides for the pass through of the credit for organizations the income of which is taxed to another person but provides that no credit is permissible when the income is not taxable. Thus, for tax-exempt organizations the credit is only allowable for investments related to unrelated business income.

Proposed Subparagraph (r)(1)(A) will define a community business of an "eligible § 501(d) organization" as an unrelated business for purposes of § 48(A)(4). The provision will not apply to any non-business investments.

Subparagraph (r)(1)(B) provides that the qualified investment is apportioned pro rata among the members in the same manner as the income. Thus, if a member is allocated one percent of the income for his share, he would be allocated one percent of the investment.

Subparagraph (r)(1)(C) tracks provisions related to pass through for other types of organizations so that qualified investment by the organization is treated as new property by the member if it was new property at the outset.

Paragraph (r)(2) applies the used property limitation at the organization level. This makes it unnecessary to provide a separate limitation at the individual level when no credit would be allowed to a member in Paragraph (4) if he claims credit for investments other than investments by the § 501(d). This simplification of the statute is possible since a member of the religious community is by his membership in the community excluded from investment in property other than through the community. In the relatively rare instance when a member changes communities during the year, the member would be required to choose, since he would not be able to claim for both communities.

Subparagraph 3 provides for recapture to be determined at the organization level. The burden is to be borne in the same way the income for the year of recapture is allocated. This avoids any problems of tracing.

The scope of the Section is limited by Paragraph (5) to the organizaations that have demonstrated a stability, so that the Service would not be facing the problem of a short-lived community that had claimed the credit and then had disappeared. The suggested test is that the religious community must have been in existence for more than five years, or more than one-half of its members have been a member of a religious community for more than five years.

Our attention has been directed to the apparent anomaly of a pro rata allocation of credit and income when a religious community maintains one or more persons at a substantially higher standard of living than most members. Therefore, we propose a new Subparagraph 5(c) be added to exclude the term "501(d) eligible organization." Any organization that provides a substantially higher standard of living for any person or persons than it does for the majority of the community could not avail itself of the pass through. The person supported in the manner substantially higher than the members as a whole could be a person other than a member.

The effective date of the bill will make it applicable to periods beginning after December 31, 1978. This is based upon our belief that the omission of a specific provision in the statute is merely an oversight and most of the corrections in the 1982 Technical Corrections Act and other similar bills have had the same effective date as a legislation that was being corrected. However, the oversight in this instance is of such duration that this seems improper. Therefore, we have suggested an effective date that would be applicable to those years that would normally be open at the time of the decision in *Kleinsasser.*

We appreciate this opportunity to present our sttement. We look forward to working with the staff to perfect this legislation and to its early reporting, passage and enactment.

Chairman STARK. Proceed.

STATEMENT OF JACOB WOLLMAN, PRESIDENT, WARDEN, WA, HUTTERIAN BRETHREN, COMMUNITIES OF HUTTERIAN BRETHREN IN WASHINGTON STATE

Brother WOLLMAN. My name is Jacob Wollman, president of Warden Hutterian Brethren. We are a community which lives in the State of Washington which is about 100 miles south of Spokane.

We are a farming community and we derive all of our income from agriculture. We are not a community which is based on material things.

We are a community which provides for our members because we believe that is the way the Lord has put the way before us.

We believe the command of love and we have to do what we are doing. That is why we are having communal cooperation and that is why in this case everybody works at the communal task and we have all of our income put together.

Being that we are farmers in the State of Washington, we do a lot of extensive farming. I have with me here a display of 10 different crops which we in our own community raise right now.

To raise crops like that takes a lot of equipment. There are different crops of many varieties.

We have over the years been recognized in the State of Washington to be very efficient farmers and stewards of the land. We can only do that if we are able to purchase equipment and facilities and keep these crops in good order whereby we can have investment tax credits like other people.

We pay taxes on this—pay taxes like other Americans do. We pay taxes on our income. Naturally right now the farming industry is at a very, very low ebb.

I don't have to tell you that agriculture is in a very, very tough situation. Our farm prices are low. We need these tax credits for survival.

We need to be able to spend our moneys, put our moneys back into our land and equipment and facilities whereby we can provide for our people.

We take care of our own people. We believe that we should be no burden to the Government whatsoever.

We educate our children with State accredited teachers. We teach honesty, respect for law and order, and all that I am asking is that we get a fair break.

We want to have and be able to spend our money like all other organizations can spend and get the benefits whereby we are then an asset to our area when we can buy equipment and have the latest in equipment and get the advantage which we absolutely need.

Thank you for letting me testify.

Chairman STARK. Thank you very much. Do you want to proceed with whom?

Mr. HUFFAKER. I would like Father Paschal Phillips to relate the situation in the Trappist monasteries.

STATEMENT OF FATHER PASCHAL PHILLIPS, OUR LADY OF GUADALUPE MONASTERY, ORDER OF THE CISTERCIANS OF THE STRICT OBSERVANCE, LAFAYETTE, OR

Father **Phillips**. I am Paschal Phillips, business manager of the Trappist Monastery in Oregon. Our rules were written about the year 530.

The Trappists came to the United States in 1849 and we have been established in my community for 40 years. The point being that we are stable communities which need to invest in a regular manner to stay alive.

We are a Roman Catholic organization. You are probably aware that most Roman Catholic organizations are listed under 501(c)(3). We found that it didn't fit us which emphasizes the fact that it is not a denominational question, it is a question of the internal organization of the community.

We found the section 501(d) fits what we really are. We really divide all the income. That is the reality of it.

So it fits. But we cannot understand why we can't get the investment tax credit because the purpose of the investment credit was to stimulate the purchase of productive equipment.

The purpose is equally well satisfied whether it is a Trappist community or some other group that buys.

There doesn't seem to be any—like the ninth circuit, there seemed to be no reason whatever. All the monks work, the income is very limited, partly because we only work 4 hours a day, and what surplus we have is distributed to the poor.

So the community lives a very modest life. Nevertheless, we do produce in my community a fruitcake. I also gave you all a booklet where the centerfold shows the monks working. We have a forest industry and we are bookbinders. We are all commercial and we don't object to paying taxes, never have. That is fine. All we ask that we be taxed in the same basis as our neighbor down the street.

Thank you for this opportunity.

Chairman **Stark**. Thank you, Father Phillips.

Mr. **Huffaker**. The remaining group which is the Society of Brothers, have communities in Connecticut which explains Mrs. Kennelly's sponsorship, one in Pennsylvania, which exlpains Mr. Schulze's cosponsorship, and one in New York.

Alan Stevenson will explain to you how these communities conduct themselves.

STATEMENT OF ALAN J. STEVENSON, DEER RUN HUTTERIAN SOCIETY OF BROTHERS, COMMUNITIES OF THE SOCIETY OF BROTHERS, NORWALK, CT

Brother **Stevenson**. My name is Alan Stevenson, and I represent the three Hutterian Societies of Brothers Communities in New York, Pennsylvania, and Connecticut. We do belong to the Hutterian Church of which Jake Wollman has told us, but we evolved differently.

We evolved in Germany, and with a total commitment to a Christian life and were expelled under Hitler and after some wanderings we settled in America where we were very gratified to have religious freedom.

We have been here for 30 years and in that time we have built up a business of supplying kindergarten equipment and school equipment to schools and kindergartens and day care centers and church schools all over the country.

In recent years we have also manufactured equipment for handicapped people. I think there is a catalogue of just our handicapped items.

This enterprise has supported us over the years and we do buy machinery, of course, for our workshops, which are woodwork and metal shops. Since we buy the machinery, it would help us to have the pass through of the investment credit.

I thank you.

Chairman STARK. Thank you, Mr. Stevenson.

Did the Bruderhof grow out of the Catholic religion in Germany or Lutheran or what?

Mr. STEVENSON. No. Independently, separately.

Chairman STARK. Independently, OK.

Mr. HUFFAKER. Jacob Huter was martyred in the 16th century and the Huterites have been persecuted by the Catholics and Lutherans, whoever was in power at the moment, but it was Hitler who finally chased them out.

But they are very close to the Mennonites in theology. In conclusion, Mr. Chairman, we don't see an unfair advantage in providing the ITC, we see removal of what was really an unintended disadvantage.

There are very few of these communities, they are small, don't represent big dollars, don't have a regular congressional presence, we think it was basically an oversight and I am pleased to announce that Mr. Foley will be submitting a statement for the record, also former Governor Brown of California will be submitting a statement for the record.

I am pleased to announce that Mr. Foley is going to reintroduce the bill next year and we hope that all who are cosponsors this year will again cosponsor if we are not so fortunate to get it through this Congress. Thank you very much.

Chairman STARK. Thank you, Mr. Huffaker.

If I understand this, of the approximately—how many societies would fall under this particular provision? How many communities are there in the United States?

Mr. HUFFAKER. I asked IRS some time ago, and they told me 75. Someone else has indicated a few more. But that is the range.

Chairman STARK. Do they all, from time to time, or regularly, pay taxes? Or do some just break even year after year after year?

Mr. HUFFAKER. If you only break even, there would be no way to feed the members. Part of this, with both the Hutterite community and the Trappist community, they are not living on charity; they must support themselves.

Since your personal living expenses are not deductible, you have got to be making money in order to feed yourself and house yourself and clothe yourself.

So, yes, it is quite possible it may not make enough money to reach out and help others. But on a regular basis, they are going to be at least self-supporting.

Chairman STARK. That was my question.

First of all, I commend you all for your basic philosophy. And also I am sorry that it is necessary for you all to make this journey. I am sure there are more productive things you could be doing today. But, for the Chair's part, your testimony falls on receptive ears. It is a bill which enjoys much support in the committee, and my hope is that we can pass it.

I must say there is a chance many of us on the committee might like to eliminate the investment tax credit altogether, which would be another way of solving your problem. Although I might say, concomitant with that, we would lower your tax rates. Again, I am not sure that is as desirable to you, but that might indeed be another result.

We await the Treasury's submission to us of a plan later this year or next year, whichever Treasury it may be or under whichever administration it may be, for some type of tax reform. And that may be another way of solving it.

But I assure you that it would be my intention at the proper time in the next Congress, if I am fortunate enough to return, that we would like to look at this issue.

Mr. Duncan.

Mr. **Duncan**. Thank you, Mr. Chairman.

I want to thank you for being here. In fact, the chairman mentioned you coming a long distance to be with us. But let me say, I understand your problem much greater by you being here personally than I would have just by reading about it. You have been most helpful, and I look forward to some help being afforded you folks in the next year, anyway.

Mr. **Huffaker**. Thank you very much.

Chairman **Stark**. Thank you all very much.

Mr. Odegard, vice president of the University of Minnesota Foundation; Mr. Edward Cain of the Apache Corp.; Mr. C. Andrew Graham, EMCOR Petroleum, on behalf of the Oil Investment Institute.

I think those are all the witnesses. Mr. Scoggins has already testified earlier on H.R. 4147, and I am told he will not return.

Again, your entire testimony and any exhibits appended thereto, or any testimony of other members of other organizations will appear in the record in their entirety. I would ask you to summarize or add any additional comments you would like to make to your prepared testimony.

Also, as you may be aware, the Treasury opposes H.R. 4167, as was outlined this morning in their presentation. I would say—and I am not sure that I have any feeling about their opposition—but I have a concern that I am faced with, and you might want to address that, and that is, I have felt a little like a racist at the bridge or Custer leading the troops, depending on which way you want to view it, in trying to stem the pressure to exempt certain foundations from unrelated business income due to owning control of other corporations.

So the fear that I would have, from a tax theory basis, is that if we allowed this, at what point do we say you are not operating a business, like a newspaper or resort hotel or whatever, is the issue that people are suggesting we exempt certain foundations for, because the newspapers are good for America, and so are oil wells good for America, and I suppose so is the Broadmoor Hotel. That is a concern that I have, and that is just that if we allow this exemption, are we in fact allowing operating businesses to be controlled by foundations or charitable institutions?

So I guess—who is up first? Mr. Odegard.

STATEMENT OF ROBERT J. ODEGARD, VICE PRESIDENT AND EXECUTIVE DIRECTOR, UNIVERSITY OF MINNESOTA FOUNDATION

Mr. ODEGARD. Thank you, Mr. Chairman.

I appreciate the chance to appear here.

I am Bob Odegard, vice president and executive director of the University of Minnesota Foundation. I speak only for the educational institutions represented here.

As you know, private fund raising has become a more and more important part of the funding of all educational institutions, both public and private. At the University of Minnesota, for example, we received $62.6 million in voluntary support last year, which is quite a substantial help to the taxpayers of the State. Most of our contributions come from large contributors, as you can understand. Many of these people have investments in oil and gas exploration companies.

The objective of this bill is, as I understand it, threefold. The first is to help attract capital to the domestic oil and gas industry; second, to enable educational organizations to diversify their portfolios, an increasingly urgent need in recent years when the stock market performance has not been spectacular; and three, to encourage people to give these gifts of oil and gas interests to educational institutions without the necessity that they be dumped on the market at very depressed prices. Usually the income stream is worth more than the liquid value.

There are a number of provisions in the bill to prevent abuses. I think you probably are more familiar with those than I am. I would just like to say that all the colleagues I have talked to in the educational establishment I think would find this bill very helpful. We do have written testimony from a number of institutions, and will be able to get more. I have letters here, which I think the staff has copies of, from the University of Southern California, the University of Pennsylvania, Emory University in Atlanta, University of Arkansas, Cornell, University of Oklahoma, Yale University, Brown University, and a letter of endorsement from the American Council on Education, which represents some 1,700 colleges and universities throughout the country.

I think you would find this a very popular measure with the educators around the country.

[The prepared statement follows:]

STATEMENT OF ROBERT J. ODEGARD, VICE PRESIDENT AND EXECUTIVE DIRECTOR, UNIVERSITY OF MINNESOTA FOUNDATION

My name is Robert J. Odegard. I am Vice President and Executive Director of the University of Minnesota Foundation, 120 Merrill Hall, 100 Church Street, S.E., University of Minnesota, Minneapolis, Minnesota 55455. I appear today in support of H.R. 4167, an amendment to the Internal Revenue Code of 1954 that would permit certain educational organizations—of which my foundation is one—to invest in, and receive gifts of, oil and gas working interests held as a limited partner.

All of us in education find ourselves in the midst of one of the most unsettled and challenging periods in our history. Were it not for generous financial support from the private sector, some of our problems might be insurmountable. At the University of Minnesota, private support plays a vital part in helping to maintain the quality of this great educational enterprise. In 1983, the University of Minnesota received a total of $62.6 million in voluntary support. Public institutions, like ours, will continue to be increasingly dependent upon private support for a larger share of their resources.

Many of our large contributions come from people of considerable means and most of these people have some investments in oil and gas development or exploration activities. These investments are relatively illiquid, difficult to dispose of, but very valuable in terms of the income they generate. It seems to me only fair and equitable that educational institutions be allowed to invest in, or hold onto, contributed units in such investments without being subject to the unrelated business taxable income tax. Accordingly, I strongly urge your favorable consideration of H.R. 4176.

The objective of H.R. 4167 is threefold. The first, as I understand it, is to attract needed capital to the domestic oil and gas industry. The second is to enable educational organizations and qualified trusts to diversify their portfolios, and to obtain new long-term investment opportunities, by being permitted to invest a prudent portion of their funds in oil and gas activities without incurring a tax. The third is to encourage gifts of oil and gas working interests held in limited partnership form to colleges and universities to whom such income is now subject to tax. I cannot speak to the first point but I certainly believe that this proposed legislation would advance the second and third objectives.

I am aware that concern has been expressed that exemption of investments in oil and gas working interests from the unrelated business income tax may present a potential for abuse of the tax-exempt status of entities making such investments. Although I leave it to the lawyers to analyze these provisions in greater detail, I note that H.R. 4167 contains a number of safeguards that are designed to prevent any abuse of exempt status. These safeguards include provisions which—

(1) prevent the utilization whether by the exempt investor partner or any other partner of the deductions and credits attributable to the exempt investor partner's share of partnership income;

(2) prohibit the allocation of a disproportionate share of income to exempt investor partners and a disproportionate share of deductions to taxable partners;

(3) restrict exempt investors to investing in *bona fide* commercially managed partnerships by eliminating the exemption from unrelated business income tax if the exempt investor is related to the general partner; and

(4) prevent abusive arrangements, such as saleleasebacks, between taxable and nontaxable entitles.

I suggest that H.R. 4167 in no way alters the policies underlying the unrelated business income tax, i.e., that exempt organizations should not be permitted to use their exempt status to invest in a business so as to give that business an unfair competitive advantage over taxpaying entities. It does so by limiting qualified investment to that of a passive limited partner and making that investment available to all oil and gas commercial operators who want to employ the traditional format of a limited partnership to raise capital. In doing so, the Bill substantially enlarges the investment opportunities of exempt organizations that are now foreclosed from enjoying the same participation in the long-term growth of the oil and gas industry as those afforded other portfolio investors. There seems no justifiable reason why income from a diversified program of passive investments in carefully selected working interests should any more be subject to tax than investments in oil and gas royalties, which are not now subject to tax. H.R. 4167, accordingly, eliminates this unwarranted tax distinction.

Today, we managers of exempt educational endowment funds are subject to prudent investment standards under state law. H.R. 4167 would not alter these standards. They would continue to require us to make prudent, diversified investments in the oil and gas area as we must do in all other investment areas. There is no reason to preclude managers from making such investments, which may produce a greater rate of return than other types of investment and expose the institution to less risk than, say, an investment in corporate stocks producing comparable rates of return. In addition, there is no reason to require investment managers, purely for tax reasons, to sell gifts of oil and gas interests made to the fund at, usually, prices far below the present value of the income they generate.

In conclusion, I hope very much that this Subcommittee will report favorably on H.R. 4167.

UNIVERSITY OF MINNESOTA FOUNDATION,
Minneapolis, MN, July 27, 1983.

HON. ROBER WOOD,
Chairman inance Subcommittee on Taxation and Debt Management,
Senate Offic ing, Washington, DC.

DEAR SEN ACKWOOD: I hope you can support Senate File 1549 which would amend the Revenue Code of 1954 to permit certain education organizations to invest in, ive gifts from, oil and gas working interests.

All of us i ation find ourselves in the midst of one of the most unsettled and challenging in our history. Were it not for the generous financial support from the pri ctor, some of our problems might be insurmountable. At the University of M private support plays a vital part in helping to maintain the quality of t ational enterprise. Last year the University of Minnesota received a tot 4.8 million in voluntary support. I know I don't need to remind you of how wnturn in the economy has effected legislative appropriations. You are als of the demographics which will mean that our available supply of students declining throughout the next decade or two. Public institutions, like ours, w creasingly dependent upon private support for a larger share of their resour

Most of o contributions from people of considerable means and most such people have vestments in oil and gas development or exploration activities. They are re illiquid, difficult to dispose of, but very valuable in terms of the income gen It would seem to me only fair and equitable that educational institutions ved to invest in, or hold onto, contributed units in such investments with g subject to the Unrelated Business Taxable Income Tax. I strongly urg avorable consideration.

On a pers te, I enjoyed the opportunity to have breakfast with you and Wendell An when you were in Minneapolis last year. I enjoyed your half hour discour e history of western civilization.

Cordi

ROBERT J. ODEGARD,
Vice President and Executive Director.

Chairm RK. Thank you very much.

Mr. Cai

STA NT OF EDWIN E. CAIN, VICE PRESIDENT FOR ERNMENT RELATIONS, APACHE CORP.

Mr. CA nk you, Mr. Chairman.

I apprec e opportunity to be here today, and I would like to request th ave the opportunity to revise and extend my remarks.

Chairma RK. Without objection, the record stays open for a while—a r so, anyway. So we are happy to have any additional info on or comments that you would like to submit for the record

Mr. CAI nk you, Mr. Chairman.

I am rep ing Apache Corp. as vice president for government relations. e Corp., oddly enough, is an oil and gas company located in tate of Minnesota not known for its production of oil and g have been rather adept, however, at producing Presidenti lidates over the past several years.

We are and oil exploration, development and production company, ur primary focus has been on oil and gas investment prog Apache has offered registered drilling programs since 1956 s one of the first companies to offer such investment oppo es.

Apache's ur history has been a good one in the public programs, an given us the experience of working with tens of thousands stors.

We fully support H.R. 4167 and feel that it would be a good piece of legislation, for a number of reasons. Let me outline them briefly.

First of all, in the area of equal access to capital, the lack of new capital has contributed to some of the recent sharp reductions in oil and gas exploration and development. Apache, 3 years ago, managed nearly $100 million in investors' dollars in oil and gas drilling and income funds. This year, the drilling fund closed at less than $10 million. This is a significant drop over a period of 3 years—and this is, I believe, a relatively consistent trend throughout the industry. While this is a concern for the industry today, it will be a serious problem for the Nation 2 or 3 years from now.

Chairman Stark. Isn't that—just unless I am missing something—isn't that primarily because of the oil price?

Mr. Cain. I think in part. That is true, in part. But I think we will find that there is a tendency for——

Chairman Stark [continuing]. $40 a barrel—doesn't investor interest kind of pick up?

Mr. Cain. Pardon?

Chairman Stark. At $40 a barrel, don't you find investor interest kind of picking up dramatically?

Mr. Cain. I think that may be true.

Chairman Stark. If we take the regulation off gas prices, wouldn't that kind of spur investment?

Mr. Cain. I think at the present time if the regulation was taken off all gas—while perhaps this is not the hearing to discuss that—that you would find a drop in gas prices rather than an increase, because the demand for natural gas simply doesn't exist at this time.

Chairman Stark. OK. Thanks.

Mr. Cain. In the current unrelated business taxable income provisions we realize through taxation, college endowments and pension funds, and those who choose to invest in oil and gas working interests—yet, if made as limited partners they are equally as passive as other investment—we would like to respond to some of the statements of Treasury in regard to that particular issue, as well.

The other major point I wanted to discuss was the need for broad diversification of investments for pension funds and college endowments. They deserve to have the opportunity to invest in a balanced program which will provide sufficient income to support their retirees and to provide a good income for their endowments. Currently, many small pension funds are deprived of the opportunity of investing in oil and gas interests because of the UBTI.

There was a statement made in the Senate hearings by Paul Overgard that bears repeating. He is the manager of small pension funds through his organization, Independent Service Co., He stated, "This legislation will make prudent diversification possible, and will be of particular interest to the kind of plan that we serve."

There are millions of small employers in this country, and a great many of them will welcome this change as an opportunity to diversify investments and hopefully achieve a better rate of return and, thus, a better retirement for their employees.

The larger pension funds have a better opportunity to customize their own investments. They can do this, to some extent in gas and oil. But the smaller pensions do not have that capability.

The final point I want to emphasize is the problem created by current law in regard to gifts to colleges and university foundations. Apache, like many other energy companies, is committed to the support of our educational system. There are five officers of our company who are serving on college and university boards, boards of education and as trustees. There is a great interest in their continuing operations and financing. We are concerned about the fact that our company's oil and gas working interests cannot be contributed as gifts to the colleges and universities we represent. We hope to continue our involvement, work, and associations with the college and university foundations for this purpose.

I understand that H.R. 4167 will produce no revenue loss, and from that standpoint, additional tax deductions such as the deductions for depletion and intangible drilling costs, will not only be foregone by exempt institutions but will not be utilized by other investors.

In regard to pension funds, you will find that these investors will be paying taxes on this money eventually as they move into their retirement period.

So I would like to encourage this committee to move with all haste and report this bill favorably.

Thank you.

[The prepared statement and additional comments follow:]

STATEMENT OF EDWIN E. CAIN, VICE PRESIDENT FOR GOVERNMENT RELATIONS, APACHE CORP.

Mr. Chairman, my name is Edwin E. Cain. I am representing Apache Corporation as Vice President for Government Relations. Apache Corporation is a domestic oil and gas exploration, development and production company with major agriculture operations in Wyoming and California. Apache has since 1956 offered to the public limited partnership interests in registered drilling partnerships, one of the first companies to offer this type of investment program. Its corporate headquarters are located in Minneapolis, Minnesota, and it has operations in more than 30 states.

Apache's twenty-six history in oil and gas public programs and its experience in working with tens of thousands of investors during this period has enabled the corporation to develop a reputation for sound, careful management. Based on our experience and our knowledge of the industry, Apache fully supports H.R. 4167, introduced by Congressman Jenkins and co-sponsored by twenty-two of his colleagues.

H.R. 4167 would permit qualified trusts and certain educational institutions to receive income from limited partnership that own working interests in domestic oil and gas properties without becoming subject to tax under the unrelated business taxable income provisions of the Internal Revenue Code.

In the brief time allotted me today, I would like to emphasize three major points which demonstrate the need for amending this provision of the Internal Revenue Code, one which has existed for more than 30 years.

1. EQUAL ACCESS TO CAPITAL

Petroleum exploration and development is a capital intensive business, requiring continuous infusions of new capital. The lack of new capital has contributed to the recent sharp reduction in the exploration and development activities of the 7,000 independent producers who are responsible for developing most of the nation's new oil and gas production. The domestic oil and gas industry's need for capital from the investing public to explore for and develop reserves is exactly the same as that of dividend and interest paying commercial corporations. Yet although interest and dividend income from normal commercial operations is not unrelated taxable income, income from oil and gas operations (other than royalties) is so taxed. The current unrelated business taxable income provisions penalize, through taxation, those college endowments and pension funds that choose to invest in oil and gas working interests. Yet these investments, if made as limited partners, are equally as passive as their other investments.

Thus, the unrelated business income tax effectively precludes access to an investment pool of more than $500 billion for the oil and gas industry while depriving pensions and endowment funds of the potentially higher rates of return that such investments afford.

2. DIVERSIFICATION OF INVESTMENTS

Broad diversification of investments is the basis of sound money management. Energy industry investments frequently are structured in a format other than the traditional stocks and bonds. While large pension trusts have developed programs and procedures for investing in gas and oil activities to take advantage of this phenomenon, the smaller endowments and pension funds have been deprived of this opportunity, because investment opportunities cannot be tailored to their needs without creating unrelated business income.

In his testimony before the Senate Finance Committee on August 1, 1983, concerning the Senate version of H.R. 4167, Paul Overgaard, manager of small pension funds for Independent Service Company, stated "This legislation will make prudent diversification possible and will be of particular interest to the kind of plans we serve. There are millions of small employers in this country, and a great many of them will welcome this change as an opportunity to diversify their investments and hopefully achieve a better rate of return and, thus, a better retirement for their employees."

3. GIFTS TO EDUCATIONAL INSTITUTIONS

A major concern among Apache management has been the inability of college and university endowments to accept gifts of oil and gas limited partnership interests. Currently, five Apache officers and managers are serving on the boards of educational institutions. I am sure this is not unusual among energy companies throughout the United States. A recent experience by an Apache officer resulted in a significant donation to a university being rejected on the basis that it would produce unrelated business income tax. This is neither a unique nor an unusual situation. Under current law, when a tax-exempt organization accepts gifts of oil and gas properties owned in limited partnership form, such investments are usually sold at a considerable loss in order for the organization to avoid becoming subject to the unrelated business income tax.

Many investors in oil and gas limited partnerships are active alumni and supporters of their educational institutions. H.R. 4167 will provide opportunities for gifts and investments that our colleges and universities sorely need.

Higher education has been confronted with severe economic problems during the past few years. Traditional sources of revenue have been greatly reduced at the very time that greater demands are being made on these institutions. H.R. 4167 permits college and university endowments to receive gifts of oil and gas limited partnership interests, thus providing a much needed, new source of income.

Mr. Chairman, it is my understanding that this legislation will result in no revenue loss because exempt institutions that are not now investing in oil and gas properties will do so in the future by transferring to this industry investment funds already producing income that is not taxed. In addition, the tax deductions, such as the deductions for depletion and intangible drilling costs, will not only be foregone by the exempt investing institutions themselves but will not be utilized by any other investor. H.R. 4167 is clearly beneficial to the domestic oil and gas industry. It is clearly beneficial to educational endowment funds and pension trusts across the country. It will cost the Treasury nothing. All of this being so, I can't think of more sensible legislation. I hope that H.R. 4167 will be favorably reported by this Subcommittee.

ADDITIONAL COMMENTS OF EDWIN E. CAIN

At the hearing held before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means on H.R. 4167 on October 3, 1984, Mr. Mikel M. Rollyson, Acting Tax Legislative Counsel of the Department of the Treasury, appeared in opposition to H.R. 4167. He advanced a number of reasons for Treasury's opposition to H.R. 4167. These comments are submitted in response to Mr. Rollyson's testimony.

HR 4167 will not lead to repeal of the unrelated business income tax

Mr. Rollyson's first objection is that enactment of this legislation can be expected to lead to repeal of the unrelated business income tax wherever exempt organizations invest through limited partnerships. This conclusion represents a misunderstanding of the forms of oil and gas investments and of the competitive effects of the bill, coupled with an overly restrictive interpretation of the intent of Congress in enacting Section 512 of the Internal Revenue Code in 1950 (which excluded, among other items, royalties and net profit interests from unrelated business taxable income).

Treasury appears to fear that H.R. 4167 will constitute precedent that would erode the long-standing rule that an exempt organization's share of income from a partnership is unrelated business taxable income regardless of whether the exempt organization is holding its interest in general or limited partnership form. This, most assuredly, will not be the case. In permitting certain exempt investors to hold oil and gas working interests as limited partners without incurring unrelated business income tax, H.R. 4167 is effectuating a limited legislative change that would do no more than equate one type of passive investment in oil and gas properties (i.e., investments as limited partners in working interests) with a type of passive investment in oil and gas interests that has long been exempt from unrelated business income tax under IRC § 512 (i.e., investments in royalties, net profit interests and production payments). The limited partnership format is used as a ready administrative device to assure that the owner of the working interest holds the investment passively, thereby equating it in all respects to a royalty or net profit interest. There would be no policy or other reason to extend the principle of H.R. 4167 to free exempt limited partners from tax on income from active types of business operations such as automobile manufacturing or spaghetti making.

Operating interests (*i.e.*, working interests) and nonoperating interests (*i.e.*, royalty and net profit interests) are treated differently for purposes of the unrelated business income tax even though the exempt organization may engage in no greater activities with respect to the operating interest than the nonoperating interest. It is the nature of the interest in the properties and not the activities with respect to them which determines the existence of a "trade or business." This lack of differentiation between type of interest and nature of activities for tax purposes is not a rational one and, as discussed below, no policy consideration requires that it be maintained.

The legislative history of the Revenue Act of 1950 discloses no policy reason why income from working interests, if held passively, should be treated differently from income from rents, royalties, dividends and interest, which, as Mr. Robinson observed, are the traditional types of income long recognized as proper for educational and charitable organizations. The purpose of the unrelated business income tax was to prevent tax exempt organizations engaged in business from gaining a competitive advantage over taxable businesses. However, the legislative history makes it clear that Congress intended to exclude "overriding" royalties from unrelated business taxable income, thereby benefitting the landowner. H. Rep. No. 2319, 81st Cong., 2d Sess. 38 (1950). The regulations extended the definition of royalty to include net profit interests and certain production payments. Treas. Reg. § 1.512(b)-1(b). Excluding such income from unrelated income has obviously not resulted in serious competition for taxable businesses having similar income. However, Mr. Robinson implies that extending the definition of royalties to include passively-held working interests would be likely to result in serious new competition for taxable businesses having similar income. The contrary is, in fact, the case: this action will stimulate competition in the oil and gas industry.

H.R. 4167 will stimulate competition in the oil and gas industry

A fair reading of the bill discloses that it is neither intended to, nor will its consequences be, to provide exempt organizations with an anti-competitive advantage over taxable oil and gas businesses. Rather, the purpose of the legislation is to facilitate—without any material loss of revenue—increased portfolio investment by exempt organizations in the oil and gas industry through established investment channels, thereby benefitting the entire industry. This is done by requiring such investment to be made through programs managed and operated by taxable, non-controlled general partners. In this way, all taxable oil and gas operators will have access on equal terms to a new source of capital. At present, investment by exempt organizations in oil and gas properties can be made only through liquidating vehicles such as royalty trusts or through highly sophisticated institutional programs especially designed for major exempt funds.

Further, the proposed ligislation is no more anti-competitive than existing law as it applies to oil and gas investment. Under present law, tax-exempt investors can pool tax-exempt income by investing in royalty interests or net profit interests. As I have noted above, income from these types of investments is excluded from unrelated business income tax. Such income can therefore be accumulated without tax by the exempt organization to acquire further investments.

Limited partners are passive investors

Mr. Rollyson argues that limited partners are not "necessarily" passive investors and that they enjoy opportunities for "substantial active involvement" in the business of the venture. This appears to be a clear misreading by him of the law of limited partnerships. The rights granted to limited partners under the 1976 Revised Uniform Limited Partnership Act (RULPA), as under its predecessor, the Uniform Limited Partnership Act (ULPA), are in fact extremely restricted.

Basically, these rights are to inspect and copy certain of the partnership records (§ 305(1)); to obtain from the general partner information about the state of the business and financial condition of the partnership (§ 305(2)(i)), copies of the partnership's tax returns (§ 305(2)(ii)), and other information regarding the partnership's affairs as is just and reasonable; and to apply for judicial dissolution and winding up of the partnership (§§ 802, 803). In addition, but only to the extent that the partnership agreement does not have specific governing provisions, a limited partner is entitled to allocations of profits and losses (§ 503) and distributions (§ 504) on the basis of his relative contribution; to withdraw upon six months' notice (§ 603); upon withdrawal to receive the fair value of his interest (§ 604); to assign his interest (§ 702); to wind up the partnership (§ 803); and to receive distributions upon winding up of the partnership (§ 804). Whether rights in the foregoing respects are granted in the partnership agreement or, because the agreement is silent, by RULPA, they cannot be said to cause the limited partner, his relation to the partnership's investment or the partnership's investments themselves to be active rather than "passive."

Contrary to the suggestion in the Treasury Statement, RULPA does not give a limited partner the right to consult with and advise a general partner or to vote on removal of a general partner. Those are simply some of the activities that a limited partner may engage in without being considered to have participated in control of the business of the partnership so as to endanger his limited liability (§ 303). For a limited partner to have rights in those respects, they must be granted in the partnership agreement. Even where rights in those respects are granted in the partnership agreement—for instance, the right of limited partners having a specified minimum percentage of the total partnership interests to vote to remove a general partner or to dissolve the partnership—they do not cause the limited partners to be other than "passive" investors in the partnership. Corporate investors also have voting rights, but exempt organizations holding stock in corporations are not deemed to be active investors merely by virtue of possessing such rights. Both the investing limited partner and the investment that results in distribution to him of a share of partnership income are no less "passive" than the nonmanager stockholder of a corporation and the investment that results in dividends to him out of corporate income.

The question of special allocations

Mr. Rollyson further indicated concern that partnership allocations may be used to transfer tax benefits from tax-exempt partners to taxable partners. The bill already contains a number of provisions carefully designed to deal with this problem, and I am sure the sponsors of the legislation would have no objection to amending the legislation to include further restrictions designed to remedy any technical difficulties identified by Mr. Rollyson.

I would also like to point out that after the introduction of H.R. 4167, Congress developed special rules for dealing with the problem of allocations of income and loss between taxable and tax-exempt partners as part of the tax-exempt leasing provisions of the Tax Reform Act of 1984. These provisions are contained in Section 168(j)(9) of the Internal Revenue Code, and I am sure the sponsors of the legislation would not object to substituting a cross-reference to the requirements of Section 168(j)(9) for the allocation rules presently contained in the bill. Indeed, the provision exempting real estate investments of certain exempt organizations from the acquisition indebtedness rules (IRC § 514(c)(9)) was amended in the 1984 Act to include a cross-reference to that subsection.

Other concerns

Mr. Rollyson also expressed concern that investments by exempt entities in limited partnerships might be used to benefit taxable partners in ways other than by the transfer of tax benefits. For example, a limited partnership with exempt partners might conduct exploratory drilling on a tract of land that could benefit the owners of adjacent land. This is a problem that exists with respect to any investment by tax-exempt entities regardless of the form of investment. Moreover, the problem may be less pronounced in the area of investment in oil and gas limited partneships because state laws and the guidelines of the North American Securities Administrators Association impose fiduciary obligations on general partners that run to limited partners, taxable and exempt alike.

Mr. Rollyson's final point is that H.R. 4167's allowance of debt financing would lead to the abusive use of exceptions. He objects in particular to the fact that restrictions on sale-leasebacks in the bill do not apply to sale-leasebacks between the limited partnership and a person related to the general partner. The answer to this concern is that it is frequently necessary in the oil and gas industry to permit financing arrangements or property transfers between affiliated entities and the bill not only contains the same anti-abuse provisions included by Congress in IRC § 514(c)(9) (relating to real estate debt financing by pension funds) but also a further safeguard against sale-leaseback abuses, namely, that the terms of any sale or lease must be consistent with the terms of similar transfers in the geographic area. Since such similar transfers would involve taxable persons on both sides of the transaction, it is just not likely, as an economic matter, that oil and gas programs operated by taxable general partners but having exempt limited partners would be able to trade on the exempt status of the latter. if so, the Treasury is provided with adequate tools in its arsenal to attack the transaction.

Chairman STARK. Mr. Graham.

STATEMENT OF C. ANDREW GRAHAM, PRESIDENT, OIL INVESTMENT INSTITUTE, AND PRESIDENT, CHAIRMAN OF THE BOARD, AND CHIEF EXECUTIVE OFFICER, OF EMCOR PETROLEUM, INC., DENVER, CO

Mr. GRAHAM. Thank you, Mr. Chairman.

My name is Andy Graham. I am the president of the Oil Investment Institute. I also serve as chairman of EMCOR Petroleum out of Denver, CO. We sponsor SEC registered public oil and gas income programs for the public.

We appreciate the opportunity to appear before the subcommittee to express our support for this bill and I respectfully request that this statement be made a part of the permanent record of this hearing.

Chairman STARK. Without objection.

Mr. GRAHAM. The Oil Investment Institute is a national trade association comprised of 28 independent oil and gas producers who sponsor federally-registered limited partnerships for oil and gas. These companies account for approximately 80 percent of all the public funds invested and our members cumulatively manage currently in excess of $6 billion of public funds.

In our role as a manager of these funds, the performance record of public oil income programs in preserving capital and providing attractive returns has drawn the attention and the interest of retirement trusts and college endowments.

These entities are seeking to enlarge their investment opportunities by accessing the domestic oil and gas industry. Investments which provide increased rates of return, long-term growth possibilities, and portfolio diversification are being sought by these portfolio managers.

Because the Tax Code currently permits an investment by tax exempt entities in such things as royalties and net operating profits, oil company debt and stocks without the imposition of the unrelated business taxable income, certain sponsors have structured oil investments for the tax-exempt investors. Most sponsors, however, are deterred by the cost of creating these so-called hybrid type investments because they are fraught with conflict and also great uncertainty.

As I see the bill, it simply permits sponsors of oil and gas programs to offer the same investment to taxable and nontaxable investors. It eliminates the current distinction in the tax law which differentiates between certain types of investments for exempt organizations. Both parties want the protection of investing as limited partners with a limited liability and a limited activity in the management of these entities.

Both, however, want exposure to the income producing qualities of oil and gas. Both want the economic potential and inflation hedge available in the domestic oil and gas activity area.

After examining a number of offerings designed for the tax exempt market, I frankly discern little difference between them and the widely offered public oil programs sponsored by OII members in terms of investment quality and risk.

Clearly the members of the OII have a self-interest in supporting this bill.

First, our members are experienced in the management of investments whose business purpose is to invest in oil and natural gas.

Second, this amendment can fulfill the need for the tax exempt investment managers to achieve increases in the rate of return earned on their investments.

This, of course, means more business for program sponsors, but more importantly, it meets the contemporary needs of the tax-exempt investor for a better yield and broader portfolio diversification.

It does this in a straightforward and simple manner rather than a convoluted manner.

In summation, the OII believes this bill will accomplish three major goals while maintaining adequate safeguards against abuse:

First, tax exempt entities will be permitted to diversify their portfolios into a prudent portion of oil and gas investments;

Second, colleges and universities will be permitted to solicit and retain donated oil and gas property interests without incurring taxable income; and

Third, it will provide additional sources of capital to the domestic oil and gas industry.

As noted by Mr. Cain, I would also note in closing that the exemption for limited partnerships provided in this bill would not have a detrimental effect on Federal revenues since Treasury currently receives no income from this source.

In fact, it should be anticipated that in time some additional tax revenues will be generated from this bill in that the bill requires that the general partner of these partnerships be a taxpaying entity.

In addressing some of the specific thoughts that the chairman mentioned, I think it is important to point out that what we are really discussing in this instance is primarily a tax deferral rather than a tax-exempt situation.

The pension trust and college endowments would be the only two entities or organizations, who would be participants in this type of activity. So I do not think from a tax theory point of view that this is extending anything beyond what is currently being done except it is doing it in a straightforward manner rather than what is being done indirectly at the present time.

[The prepared statement follows:]

Statement of C. Andrew Graham, President, Oil Investment Institute

INTRODUCTION

Mr. Chairman, my name is C. Andrew Graham, and I am the President of the Oil Investment Institute. I also serve as CEO and Chairman of the Board of EMCOR Petroleum, Inc., a general partner located in Denver, Colorado, offering limited partnership interests in oil and gas income funds to the public.

The Oil Investment Institute (OII) was founded in 1969 as a trade association of firms acting as general partners in oil and gas limited partnerships being offered to the investing public. The OII set up high standards for business operating practices, and all members agred to uphold these high standards. While OII has no power to enforce these standards due to U.S. anti-trust laws, no member has ever been charged by a federal agency with violations of securities or tax laws to the best of my knowledge.

In the early 1970's, OII worked with the SEC to develop standardized regulations governing public oil and gas programs, which resulted in a tough set of policy regulations being adopted in 1972 by the North American Securities Administrators Association, which is the association of state securities commissioners.

Exhibits G and H list our 26 sponsoring members who have the ability to vote on policy questions raised by the Board of Governors and our 60 or so general members who participate more indirectly in OII decision making. Sponsor memberships are open to those who have been or who are in the business of offering oil and gas limited partnerships to the public and acting as general partner. These funds run the gamut from exploration and development drilling to master limited partnerships to income and well-completion funds. General membership is open to all with an interest in this industry.

OII members account for about 70–80% of all the funds raised for oil and gas limited partnerships. About $2.05 billion was raised by OII members in 1983, and about $1.6 billion in 1982. About half our members offer oil and gas income funds, and the other half offer drilling funds. Some members sponsor both types, while only a few offer completion funds and master limited partnerships.

There has been rapid growth in the oil and natural gas income fund industry since this investment concept was first introducted by Petro-Lewis Corp., an OII sponsoring member. Prior to this period, drilling funds were the most common form of direct public investment in oil and gas reserves.

Since 1970, more than 40 companies have formed publicly-registered income funds and have raised a total of $4.9 billion of investor subscriptions. $4.3 billion of this amount has been raised since 1980. Of current income fund sponsors (23), 50% have been in the business for three years or less, and 20% for 10 years or more. More than a quarter of a million people now own an interest in America's oil and gas reserves through their investment in income funds.

Income funds have been the most popular form of direct public investment in oil and gas reserves since the sales of income programs outpaced drilling program sales in 1982. Many investors, both institutional and individual, believe that the energy crisis is NOT over, and retain an interest in oil and gas limited partnerships because rates of return and income yields have been competitive with other investment vehicles. These investors also recognize the considerable potential for improvement in the value of their hydrocarbon-producing properties due to increases in recoverable reserves and price increases for the sale of crude oil and natural gas. Therefore, the direct investment in oil and gas-producing properties through the limited partnership vehicle has significant inflation-hedging potential as well as good cash flow characteristics. The same cannot always be said for typical corporate stocks and bonds. At least three public utilities, the traditional investment for widows and orphans, have either suspended dividends or defaulted on interest/principal payments of their securities in the 1970–83 period.

SUMMARY OF OUR POSITION

The OII strongly support H.R. 4167. The bill will provide the independent oil industry with access to another source of domestic capital with which to fund the development and operation of our hydrocarbon resource base. The tax code currently discourages qualified pension funds and educational organizations from considering an investment in oil and gas interests that bear developmental obligations (i.e., working interests) by taxing the income from such investments. However, exemptions are provided for income from oil and gas royalties, net profit interests, production payments, real estate partnerships, and corporate stocks and bonds (either of domestic or foreign issuers) because they are considered passive sources of income. We believe that an exemption from the unrelated business income tax for working interest income from oil and gas limited partnerships would comport not only with the current exemptions provided for other forms of passive oil income, but with the spirit of the tax law itself.

Financial innovation has been the hallmark of American capital markets, and a significant cause of the flexibility and strength of our economic and our financial institutions. The OII to work to help update our tax laws to reflect financial innovation so long as the changes support the concept behind the tax laws. We believe this position is preferable to developing complex methods to circumvent the spirit of the law.

Limited partners have no legal rights or abilities to control the daily management decisions of the partnership. The taxable general partner has the operating and managerial responsibilities. Moreover, such an income tax exemption for pension and endowment funds would not have a detrimental effect on Federal revenues, since Treasury currently receives no income from this source. In time, some additional positive tax income could come from the taxable general partner's share.

In the long run, we expect that a well-diverified pension or educational institution (endowment) portfolio would invest only a small portion of its assets in oil and gas limited partnership interests. These sophisticated money managers would evaluate this investment according to its risk/reward characteristics, its ability to hedge inflation and to generate income, and its ability to help them diversify their holdings, just as they have evaluated investments in international stocks and bonds and real estate.

Finally, H.R. 4167 would encourage the giving of limited partnership interests in oil and gas properties to colleges and universities, which would benefit from both the steady cash flow and the potential for capital appreciation. Currently, such educational institutions often liquidate such gifts of property at distress prices in order to avoid jeopardizing their tax-exempt status.

POTENTIAL SOURCE OF NEW CAPITAL

The independent oil industry depends on access to American capital markets in order to develop and maintain U.S. hydrocarbon supplies. Independents drill about 63% of the developmental oil wells and 84% of the developmental gas wells (1981 data), spending 49% and 62% of all such development funds, respectively. In terms of exploratory wells, independents drill 84% of the oil wells and 80% of the gas wells. Independents spend 45% of their budgets on development and 40% on exploration, while the largest eight oil and gas companies spend 36% and 34% on the same respective activities. Independents produce about 21% of U.S. crude oil and 35% of U.S. natural gas vs. 53% and 36% for the largest eight firms in the industry. Profits are down 25% in the first half of 1983 for the independents compared to a 5% decline for 26 very large companies in the oil and gas business. Therefore, capital spending for operations, development and exploration is being severely curtailed within the independent segment. This downtrend is continuing in 1984. The opportunity to tap the capital markets is important for the future business activities of these firms and the availability of domestic hydrocarbon supplies.

Drilling activity has been severely curtailed during the last 12 months or so, off about 50% from the 1981 peak of 4,521 rigs. Part of that decline reflects general economic recession, and the OPEC price increases of 1980–81. NGPA78 has also escalted gas prices at more than 20%/year in the last 5 years. Nonetheless, at least 98,000 jobs have been lost as a direct result of fewer on-shore rigs running today than in 1981. This fugure does not include all those indirectly related to drilling like steel manufacturing, refining, etc. Therefore, the health and growth of the domestic oil and gas business should be critical to American jobs and as a source of fuel to power American industry.

Qualified pension funds and educational organizations have a wide variety of passive investments from which to choose, including corporate bonds and stocks, government securities, real estate properties (through limited partnerships), mortagages, foreign stocks and bonds denominated in either U.S. dollars or other currencies, venture capital-related securities, precious metals, art, oil and gas royalties, net profits interests, and production payments. It is our belief that limited partnership interests in oil and gas income programs should also be available for investment by such funds and organizations, because they possess similar investment qualities to royalties, net profits interests, and production payments that are now exempt from unrelated business income tax.

Also, financial innovation has been a hallmark of the American capital markets, fueling our economic growth by flexibly changing sources of capital with changes in the business climate. The tax laws periodically need to be updated to reflect financial innovation that supports the spirit of our tax laws. We prefer to work to amend those laws rather than develop complex methods to circumvent them.

POSITIVE INVESTMENT CHARACTERISTICS

Investments in limited partnership interests like oil and gas income progams have positive characteristics sought by investment managers. The foremost of these characteristics is a steady cash flow from the sale of oil, because the U.S. consumes more oil than it produces domestically. Natural gas sales, though more susceptible to variations in demand, provide a similar steady cash flow. Even in the worst of times, 85% to 90% of all the domestic natural gas that can be produced is sold. Most other U.S. businesses experience much more cyclical cash flows, with profits up or down 20% over a business cycle. Moreover, the capital value of oil and gas producing properties normally fluctuates less than the current prices of corporate stocks or bonds, because reserve evaluations are consistent on a long-term basis with the production history of the producing wells.

Oil and gas investments held in limited partnerships can be, and normally are, diversified by location, type of well, and producing (geologic) formation. This reduces the geographic and geological risks inherent in owning oil and gas producing properties. Independent engineering analyses are used to audit the purchase and the operating decisions made by the general partner of a limited partnership. Oil and gas properties also have liquidity characteristics similar to real estate properties, because there is a large and active resale market. Properties are valued according to their cash flow streams and their inherent qualities in terms of proved and potential reserves, and lenders provide mortgage funds based on current income, production history, and reserves.

Experience indicates that limited partnership interests in oil and gas income programs will be excellent, safe investments for tax-exempt funds, and they compare favorably with stocks, bonds, and real estate returns.

We believe that but for the tax on unrelated business income, sophisticated U.S. investment managers would have placed approximately 5% of their total portfolios in limited partnership interests in oil and gas income programs. This represents about a $40 billion investment potential, which could be available for investment in the independent domestic oil industry if H.R. 4167 is enacted into law. These funds could help to develop and maintain our domestic hydrocarbon resource base, providing future domestic supplies of oil and gas to all U.S. consumers.

Often questions are raised about the level of expertise which pension fund managers possess regarding the oil and gas industry. ERISA (1974) holds all professional money managers to the highest standards of prudence for all the investments which they make. We believe that they are capable of choosing advisors of high caliber to help them select investments and would normally do so. While federal law cannot banish malfeasance nor incompetence, sufficient legal recourse is now available that pension funds and pensioners can sue for recompense with a high probability of success.

H.R. 4167 comports with the present exclusions from the tax on unrelated business income

The tax on unrelated business income is designed to prevent a tax-exempt organization from using its tax-exempt status to unfairly compete with taxable businesses. Exclusions from the tax are provided from income from passive investments traditionally held by tax-exempt organizations as a source of income to be used to finance tax-exempt activities. Numerous forms of passive investment are specifically excluded by statute, including oil and gas royalties, net profits interests, and production payments. These forms of investment are passive in nature, because the investor does not control the business operations that produce the income. Although the operator of the oil or gas property may use the sales proceeds from such investments to develop the interest, tax exemption is provided for the investor, because the investor does not control such development.

Similarly, current law recognizes that a tax-exempt investor can accumulate passive income from royalties, net profits, interests, and production payments, because such accumulation by reinvestment does not give the investor an unfair competitive advantage over taxable businesses. Again, because the investor dfoes not control the operations of the oil and gas properties either directly or indirectly, those operations are actually conducted by a taxable person who pays taxes just like his competitors. Hence, the royalty, net profits interest, and production payment provide a passive form income, which like interest or rental income does not give the investor a competitive advantage.

The obvious purpose of H.R. 4167 is to provide a wider selection of truly passive oil and gas investments for qualified pension funds and educational organizations. This result is achieved by treating passive investments in oil and gas properties in the form of limited partnership interests in the same manner that existing law now treats other forms of oil and gas investments. The bill simply recognizes that financial innovation has occurred over the past decade, especially in the development of other forms of passive oil and gas investments, and permits qualified pension funds and educational organizations to invest in passive limited partnership interests without incurring an income tax liability.

H.R. 4167 ensures that the limited partnership interest is truly a passive investment by prohibiting investments by tax-exempt limited partners who are related to the general partner. Thus, the bill comports with the purpose of the current exclusions for other forms of passive oil and gas income by preventing the tax-exempt investors from directly controlling the general partner. Moreover, the ability of the passive investor to reinvest income to the extent not currently needed in partnership operations does not give the investor an unfair competitive advantage over taxable businesses, because such reinvestment can only be made in similar passive forms of investment, which clearly are not anticompetitive. Indeed, H.R. 4167 will actually promote competition by making an additional source of capital available, on a nondiscriminatory basis, to the entire industry of taxpaying oil and gas operators, many of whom would try to tap this source of capital and expand their taxable activities.

NO NEGATIVE EFFECT ON FEDERAL REVENUES

Tax-exempt funds do not pay income tax on the income from their passive investments. H.R. 4167 would not change this; it would only permit the income from passive investments in oil and gas producing limited partnerships to be exempt from taxation. The mix of asset types held within a tax-exempt portfolio might change to include limited partnership interests in oil and gas income programs, but no revenues would be lost to the Treasury from the opportunity to include income-producing limited partnerships.

In the long run, independent oil companies acting as general partners to a few more partnerships could be paying more federal income tax to the US Treasury.

PROVIDE BENEFITS TO ENDOWMENTS AND FOUNDATIONS

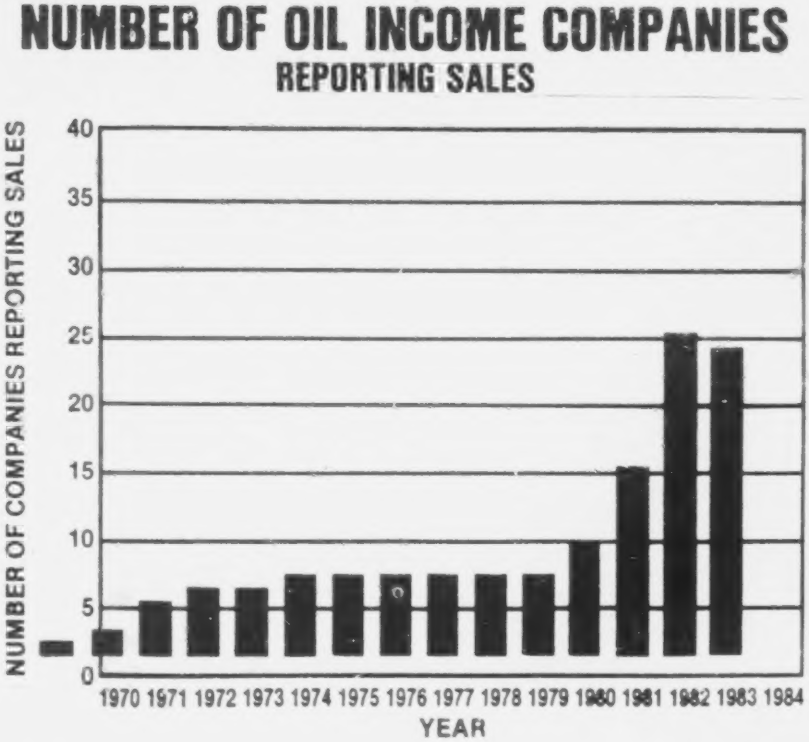
As the US population ages, our colleges and universities face declining enrollment and financial problems in meeting their operating and fixed costs. Increasingly, they must rely on income from their endowment funds. Gifts of limited partnership interests in oil and gas producing properties, with their positive investment characteristics like steady income and potential appreciation, would be beneficial. Today such gifts are often sold as quickly as possible, often at distress prices, in order to avoid potential adverse tax consequences. Under H.R. 4167, colleges and universities could retain those interests as passive limited partners.

CONCLUSION

For all of these reasons, OII supports H.R. 4167. The bill recognizes that during the past decade, dramatic changes have been made in the forms of passive oil and gas investments available for qualified pension funds and educational organizations and provides for an update to the tax code to accommodate those changes. We believe that H.R. 4167 reflects sound tax and energy policy and should be enacted into law.

Thank you.

Exhibit A



NUMBER OF OIL INCOME COMPANIES REPORTING SALES

Exhibit B

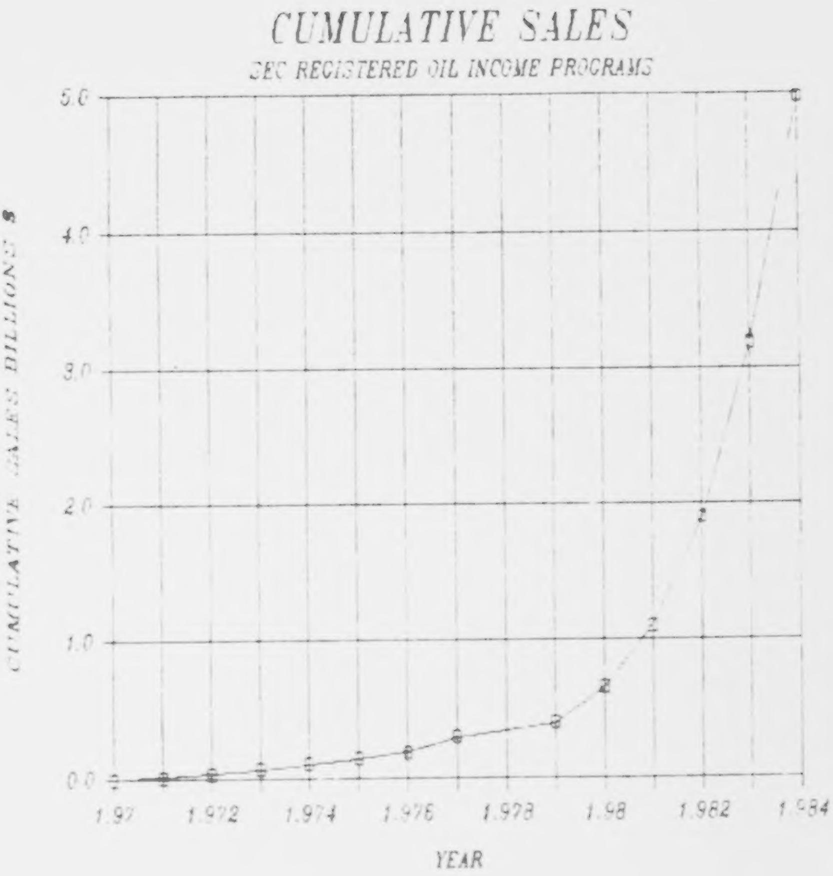

CUMULATIVE SALES
SEC REGISTERED OIL INCOME PROGRAMS
CUMULATIVE SALES BILLIONS $
5.0
4.0
3.0
2.0
1.0
0.0
1.97
1.972
1.974
1.976
1.978
1.98
1.982
1.984
YEAR

Exhibit C

OIL INCOME PROGRAM SALES

SEC REGISTERED PROGRAMS

(billions)

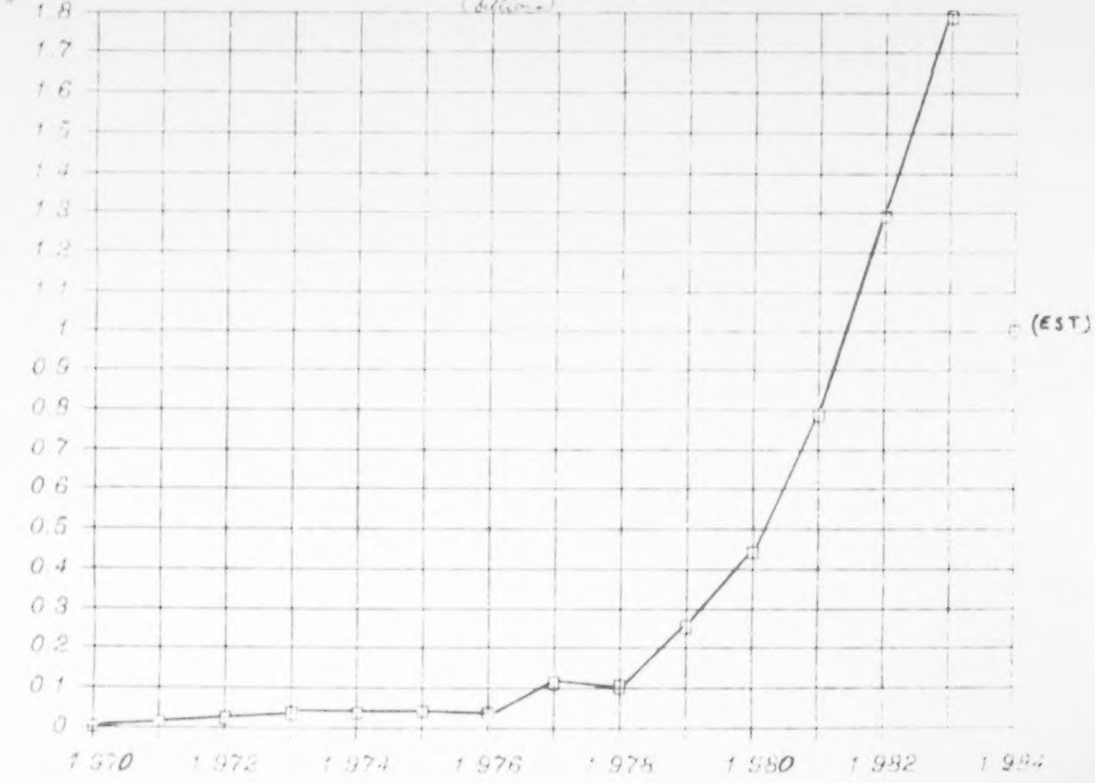


EXHIBIT D.—ESTIMATED DIRECT EMPLOYMENT IN DRILLING OPERATIONS

	Average number of rigs running	Rig workers (1)X15	Seismic crews	Seismic workers (3)X5	Support personnel (1)X45	(2) + (4) + (5) Total
1975	1,660	24,900	284	1,420	74,700	101,020
1976	1,658	24,870	260	1,300	74,610	100,780
1977	2,001	30,000	308	1,540	90,045	121,585
1978	2,259	33,900	352	1,760	101,655	137,315
1979	2,177	32,700	400	2,000	97,965	132,665
1980	2,901	43,700	530	2,650	130,950	177,300
1981	3,970	59,500	681	3,408	178,650	241,558
1982	3,203	46,800	588	2,940	144,135	193,875
1983	2,233	33,495	427	2,135	100,485	136,115
1984[1]	2,362	35,430	445	2,225	106,290	143,945
Jobs lost 1981–84 average		29,480		1,183	72,360	97,613

[1] Eight month average.

Note.—Approximately 15 workers operate a typical on-shore drilling rig, and on-shore seismic crews have about five members each. Support personnel are diverse contractors and service providers who help set up a rig site and periodically visit to perform special jobs.

EXHIBIT E

IPAMS POSITION ON CHANGING THE DEFINITION OF UNRELATED BUSINESS TAXABLE INCOME

Whereas the Independent Petroleum Association of Mountain States represents over 1800 members in the 11 Rocky Mountain states which contains a significant amount of the nation's future potential oil and gas reserves; and

Whereas this nation continues to jeopardize the nation's security by importing over one-third of its oil and unnecessary high priced gas from foreign countries; and

Whereas changing economic conditions and new investment opportunities have somewhat outdated the existing definitions for Unrelated Business Taxable Income (UBTI) applied to pensions and educational trusts; and

Whereas, the problem is that the current UBTI taxes earnings from most oil and gas production holdings of pension plans and private investments; and

Whereas the inevitable result is that pension and endowment trustees do not invest in oil and gas production and are foreclosed from higher investment returns than are available from stocks and bonds; and

Whereas oil and gas producers are thus currently excluded from drawing upon a capital pool estimated to be about $500 billion; and

Whereas the availability of capital for the independent oil and gas industry is crucial to the industry's and nation's economic health; and

Be it therefore resolved, that IPAMS strongly supports a change in the federal statutes on the definition of unrelated business taxable income so that pension and college endowments may invest through limited partnerships in working interests in oil and gas properties without being liable for taxation.

Adopted on 12/21/83 by Tax Committee.

Adopted on 12/ / / by Executive Committee.

EXHIBIT F

[From The Energy Daily, Sept. 23, 1983]

PENNZOIL FINDS A PROVEN PATH TO OIL PROPERTIES

(By Burt Solomon)

Pennzoil Co. is trying something apparently unprecedented in the annals of oil and gas financing. On Thursday, the Houston-based oil company announced it has joined with private investors to create a new corporation dedicated to buying producing properties. Pennzoil will own 49 percent of the entity (called Proven Properties Inc., or PPI) and will run it under a management contract. The unidentified investor group—comprised chiefly of institutional investors such as insurance companies and pension funds—will own 51 percent.

The new company is starting out with an asset base of $510 million, which Pennzoil officials say will support the financing of $1¼–1½ billion worth of producing properties. That's in addition to Pennzoil's own recently-renewed $2.5 billion line of credit for such purposes. (Pennzoil and PPI may join hands in buying properties.) But creating PPI won't reduce one iota Pennzoil's ability to finance its own oil and gas work, company officials insisted. Pennzoil's 1983 exploration and production budget amounts to $400 million, and its assets total $3.2 billion.

The PPI deal is complicated. Pennzoil's 49 percent share will be forked over to PPI in the form of $2348 million worth of Pennzoil preferred stock. The other 51 percent of PPI's assets also is in the guise of Pennzoil preferred stock, which the investors bought from Pennzoil for $261 million in cash. Pennzoil executives are now pondering two ideas of what to do with their cash bonanza—whether to retain it as cash or use it to pay down debt. (The latter route would reduce Pennzoil's debt load from 47-48 percent of capitalization down to 37 percent.) PPI will raise financing to buy producing properties by employing the Pennzoil preferred stock as collateral for loans and using the purchased properties themselves as additional collateral, a Pennzoil spokesman explained. PPI also anticipates having available $30 million in annual income from its Pennzoil stockholding.

"The point of forming this company," Pennzoil's spokesman said, "is that Pennzoil for the next four or five years has a fairly healthy plateful of exploration, wildcatting and producing operations, which are going to take most of our available cash. We felt that there are opportunities out there that exist right now to buy proven oil and gas reserves that are producing. So we formed PPI with that in mind."

The new entity is expected to buy mostly domestic oil and gas properties. None has been bought yet, but "we are ready, if somebody wants to walk through the door," the spokesman said.

"A nice piece of work," remarked Paine Webber researcher Bernard Picchi—one that apparently sidesteps the provisions of present tax law that discourage pension funds and other tax-exempt entities from investing directly in oil and gas properties. PPI's success in raising funds will hinge on the credit policies of the banks that will lend the money, Picchi said. PPI will contribute equity for its purchases from dividends on its (newly-issued) Pennzoil stock, while banks are expected to lend 60-80 percent of the aggregate value of the properties bought.

EXHIBIT G.—OIL INVESTMENT INSTITUTE

[SPONSORING MEMBERS (VOTING 26)]

Company	Headquarters/city
Anderson Petroleum	Denver, CO
Apache Corp.	Minneapolis, MN
Callon Petroleum	Natchez, MS
Convest Energy	Houston, TX
Damson Oil	New York City, NY
Devon Energy	Oklahoma City, OK
Dyco Petroleum	Minneapolis, MN
Energy Search	Philadelphia, PA
Energy Assets Capital Corp.	New York City, NY
Enterprise Energy	Cambridge, OH
EMCOR Petroleum, Inc.	Denver, CO
General Hydrocarbons	Billings, MT
Geodyne Resources	Tulsa, OK
GeoVest Energy, Inc.	St. Petersburg, FL
Graham Resources	New Orleans, LA
Hawkins Oil and Gas	Tulsa, OK
HCW Oil and Gas	Boston, MA
Integrated Resources Energy Group	Denver, CO
May Petroleum	Dallas, TX
Morgan Petroleum	Monterey, CA
NRM Petroluem	Dallas, TX
Petro-Lewis Corp.	Denver, CO
Petrotech Investments	St. Clair, MI
Quinoco Resources	Denver, CO
Samson Properties	Tulsa, OK
Vicorp Energy	Englewood, CO

Exhibit H.—Oil Investment Institute

GENERAL MEMBERS (NON VOTING 60)

Arter & Hadden
A.G. Edwards & Sons.
Andrews, Davis, Legg, Bixler, Milsten, Murrah, Inc.
Arthur Andersen.
Arthur Young.
Baker Drilling Equipment.
Beard Oil.
Bright & Nichols.
Buffalo Resources.
BTA Oil Producers,
CCC Advisors, Inc.
Conner & Winters.
Coopers & Lybrand.
Dain Bosworth.
Deloitte Haskins & Sells.
Doerner, Stuart, Sanders, Daniel, Anderson.
Drexel, Burnham Lambert.
Edwards & Leach Oil.
Emens, Hurd, Kegler & Ritter.
Energy Assurance.
First City National Bank of Houston.
First National Bank of Chicago.
Forest Exploration.
Highlands Energy.
Holme, Roberts & Owen.
Hydroex.
Investment Search, Inc.
Jackson, Walker, Winstead, Cantwell & Miller.
Jennings Corp.
Johnson & Swanson.
Keplinger & Associates.
Kidder Peabody.
LaClaire Petroleum.
Lawrence Energy Associates.
Mercantile National Bank at Dallas.
National Oil.
North Star Minerals.
Peat, Marwick, Mitchell & Co.
Petroleum Information.
Piper, Jaffrey & Hopwood.
Pray, Walker, Jackman, Williamson & Morlor.
Price Waterhouse.
Prudential Bache.
Resource Programs, Inc.
Riddle & Brown.
Sandefer Oil and Gas.
Scott & Stringfellow.
Robert A. Stanger & Co.
Texas National Exploration.
Touche Ross & Co.
Wallace Securities Corp.
Walker Energy.
Wilmco.

Chairman STARK. Thank you. I guess we did a similar sort of thing with real estate just recently for debt financed real estate participation.

Can you explain very briefly for me an outline of the route used by some to achieve this without legislative change?

Mr. GRAHAM. There are principally three routes, Mr. Chairman. One is through the creation of the passive interest known as the net operating profits interest.

A second is through the use of the overriding royalty interest, and

The third through the use of offshore trusts which I have to confess I am not totally familiar with.

But these are of questionable validity relative to the Tax Code, and they are nevertheless indirect ways to do in fact what the limited partnership provides which is limited liability, limited participation in the activity and also a right to receive the profits.

Chairman **Stark**. I presume that the only reason to take a partnership and dissolve it and distribute royalty interests, for example, is that you may have additional drilling opportunities or require additional capital to rework wells in the future and then you have an agreement in most of these participations that people will pony up their share of the capital, so that that would prohibit you from at some point in time just saying, OK, Apache No. 37 is done, we will just distribute royalty interests in this block of land and everybody will be separate owners.

That, I gather, is structurally a problem in the industry in general. Is that right?

Mr. **Graham**. I think that what happens in those situations, if I understand the chairman correctly, you are asking the question as to when there are additional oil and gas investment opportunities in an existing entity, what is done.

Chairman **Stark**. I know what is done. That is the only thing that seems to me that would get the colleges in. In other words, if you would have 1 acre and could only drill one well, and you would drill the well and it would never take any additional capital or you would be sure you would never need any more capital than what it would provide, you could distribute the royalty interests. You wouldn't have to do the partnership accounting.

Mr. **Graham**. That is a mechanism that can be used.

Chairman **Stark**. Is it practical if you have other wells? I guess my next question is What happens to a bank that forecloses on a loan and the examiners just let them pony up the money to keep their share of the production in a partnership, or do they have to just wait and let the other partners suffer the penalty for not providing their share of the capital? Anybody know?

Mr. **Cain**. You mean in case the bank went bankrupt?

Chairman **Stark**. As is fairly common, a limited partner of yours, let's say, may very well pledge, borrow from a bank against prospective royalty for oil payments and then let's say, like the bank down south, they borrowed more than the thing was worth.

Now, the bank might elect—they foreclosed on that interest—I guess what I am saying, let's assume it is an ongoing partnership that has drilling prospects in the future, that calls for some major capital to deepen or rework a well.

Does the bank normally put up their share of capital or do they just wait, and most of your agreements say if you don't come up with the additional capital, the other partners—what do banks normally do?

Mr. **Graham**. What banks normally do? The banks are relatively hesitant to loan against partnership interests in any regard, but those that do, if there is a foreclosure of that interest, the bank's interest is to receive its cash, and that interest will be put up for sale.

I would point out that in most programs that do involve drilling there are usually adequate capital provisions retained in the capital base of that entity to provide for a reasonable opportunity to develop the opportunities.

Once that capital is then expended, then normally any additional opportunities that appear are usually farmed out or sold to third parties.

A third point would be in those situations many sponsors—and I believe most of the sponsors that are OII members provide a liquidity means whereby they may retender that interest to the sponsor at a published price; that is, published to all the participants, and that sponsor will repurchase that interest for cash.

So those are the ways that they achieve liquidity in the normal instance.

Chairman STARK. OK. Thank you all very much.

The Chair would just state that several members of the Ways and Means Committee have submitted statements—in this case, Mr. Archer on H.R. 4167. Without objection, it will be put in the record.

Without objection, statements of any members will be accepted into the record during the 2-week period that we will leave the record open.

Is Mr. Lopeman here?

Mr. Lopeman, American Independent Refiners Asociation.

In his absence, if we have his statement here, it will appear in the record—his testimony on H.R. 4779, which Mr. Thomas testified on earlier this morning.

That concludes the hearing.

The committee stands adjourned subject to the call of the Chair.

[Whereupon, at 2:45 p.m., the hearing was adjourned.]

APPENDIX

The text, summary, and written comments received on bills which are the subject of the hearing follows. The bills are arranged in numerical order.

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98TH CONGRESS
1ST SESSION

H. R. 700

To define the circumstances under which construction workers may deduct travel and transportation expenses in computing their taxable incomes for purposes of the Federal income tax.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 6, 1983

Mr. STARK (for himself and Mr. HANCE) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To define the circumstances under which construction workers may deduct travel and transportation expenses in computing their taxable incomes for purposes of the Federal income tax.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. AMENDMENT OF INTERNAL REVENUE CODE OF 1954.

(a) TRAVEL AND TRANSPORTATION EXPENSES OF CONSTRUCTION WORKERS.—Section 162 of the Internal Revenue Code of 1954 (relating to deductions for ordinary and necessary business expenses) is amended by inserting therein the following new subsection:

"(h) SPECIAL RULE FOR CONSTRUCTION WORKERS.—

"(1) DEFINITION OF TEMPORARY JOB SITE.—For purposes of applying subsections (a)(1) and (a)(2) to travel and transportation expenses incurred by construction workers, a job at a site located more than 30 miles from a construction worker's principal place of residence—

"(A) shall be deemed to be temporary for the first 2 years that the worker is employed at that job, and

"(B) shall be determined to be temporary or not temporary with respect to periods following the first 2 years of employment based on an examination of all the facts and circumstances, subject to the rules set forth in subparagraphs (2), (3), and (4).

"(2) EFFECT OF FIRST 2 YEARS ON SUBSEQUENT DETERMINATION.—In determining whether or not a job is temporary under subparagraph (1)(B), the worker's employment at the job during the period specified in subparagraph (1)(A) shall not be taken into account.

"(3) INDEFINITE EMPLOYMENT.—No deduction shall be disallowed, by reason of section 262 or any other provision of law, solely because a construction worker's employment at a job site is of indefinite duration.

"(4) PROHIBITION ON APPLICATION OF 1 YEAR RULE.—In making the determination specified in subparagraph (1)(B), no length of time shall be deemed, either automatically or presumptively, to make the job other than temporary. The '1-year' rule set forth is Revenue Ruling 59-371, or in any similar ruling or regulation, is expressly disapproved as a grounds for disallowing deductions.

"(5) DEFINITION.—For purposes of this subsection, the term 'construction worker' means any individual employed, whether as a skilled, semiskilled, or unskilled laborer, in the building or construction industry, but does not include clerical or management employees.".

(b) TECHNICAL AMENDMENT.—Subsection 162(h) of the Internal Revenue Code of 1954 is amended by striking out "(h)" and inserting therefor "(j)".

SEC. 2. EFFECTIVE DATE.

This section shall be effective upon enactment.

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Summary and Description

PRESENT LAW

Present law allows a deduction for ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business (Code sec. 162). Traveling expenses which meet these general requirements are deductible if incurred by the taxpayer while he or she is away from home in the pursuit of a trade or business. For these purposes, traveling expenses include transportation fares as well as amounts expended for meals and lodging, other than amounts which are lavish or extravagant under the circumstances (sec. 162(a)(2); Treas. Reg. sec. 1.162-2(a)). No deduction is allowed for personal, living, or family expenses, including the cost of commuting to and from work (sec. 262; Treas. Reg. sec. 1.262-1(b)(5)).

Traveling expenses are considered to be incurred while away from home in several different situations. One such situation is when the traveling expenses are incurred in connection with temporary employment and the taxpayer has a regular or principal place of business (or, in its absence, a regular place of abode) away from which the temporary employment takes place. The term temporary from this purpose generally is defined by the Internal Revenue Service and the majority of courts to mean employment which can reasonably be expected to last only for a short period of time. By contrast, traveling expenses incurred in connection with employment which is considered to be of indefinite or indeterminate duration generally are not deductible. On numerous occasions, the courts have considered the issue of whether a particular taxpayer's employment is temporary or indefinite in nature.

EXPLANATION OF THE BILL

The bill would provide that a job at a site located more than 30 miles from the principal place of residence of a construction worker shall be deemed to be temporary for the first two years the worker is employed at that job. Accordingly, even if the employment could be considered to be of indefinite duration, the worker would be allowed to deduct travel and transportation expenses (including meals and lodging) for the first two years at a job site which is located more than 30 miles from his or her home.

The bill also would provide that after a construction worker's first two years at such a site, the determination of whether the job was temporary (so that travel and transportation expenses would still be deductible) is to be made on the basis of all the facts and circumstances, subject to three special rules set forth in the bill. First, the fact the job had already lasted two years could not be considered in determining whether or not it was temporary. Second, the mere fact that a construction worker's employment at a job site was of indefinite duration could not result in treating the job as other than temporary. Third, no length of time could be deemed, either automatically or presumptively, to make the job other than temporary.

The special traveling expense rules in the bill would apply to any individual employed in the building or construction industry (other than clerical or management employees), whether as a skilled, semi-skilled, or unskilled laborer.

EFFECTIVE DATE

The provisions of the bill would be effective on enactment.

REVENUE EFFECT

The provisions of the bill are estimated to decrease fiscal year budget receipts by $64 million in 1985, $432 million in 1986, $477 million in 1987, $524 million in 1988, and $571 million in 1989.

Statement of the American Federation of Labor and Congress of Industrial Organizations

The AFL-CIO is pleased to have an opportunity to comment on the "Miscellaneous" tax bills before this subcommittee.

We will limit our comments to H.R. 700 and H.R. 907 because those measures have an immediate and direct effect on workers. Both of these measures would make the tax code fairer and neither measure involves revenue losses of any significance.

H.R. 700 defines the circumstances under which construction workers may deduct travel and transportation expenses. The bill would have the effect of permitting construction workers to deduct their ordinary and necessary business expenses just like other taxpayers.

Under current law, the constraints and limitations on travel and business expenses do not adequately reflect the unique circumstances in the construction industry and as a result many workers are unfairly treated. Under present law traveling expenses (including meals and lodging) are deductible if incurred while away from home in the pursuit of a trade or business. Such employment however, must be temporary and expected to last a short period of time. Traveling expenses incurred in connection with employment whch is considered to be of indefinite or indeterminate duration generally are not deductible.

Construction workers are frequently employed on sites that are much too far from home to be considered within daily commuting distance. Further, construction work does not lend itself to the distinction between travel expenses resulting from temporary employment and from employment of "indefinite" duration. Thus, there is much uncertainty and much potential for inequity in denying workers deductions for legitimate costs of earning income.

H.R. 700 would provide that a job would be considered "temporary" for two years in the sense of permitting workers to deduct travel and transportation expenses if the site were located more than 30 miles from the principal place of residence.

After the first two years, determination of "temporary" or "indefinite" would be based on actual facts and circumstances without automatic linkage to any particular length of time.

We believe H.R. 700 establishes a sensible, administrable and fair set of rules to deal with the unique circumstances of many workers in the construction industry.

H.R. 907 would clear up another longstanding problem in the law concerning the tax treatment of meals furnished to an employee for the convenience of employer.

Under the just enacted 1984 tax law the value of meals provided to an employee at a subsidized eating facility operated by the employer is excluded from income and wages as de minimis fringes if (1) the facility is located on or near the employer's business premises, (2) revenue from the facility equals or exceeds direct operating costs, and (3) in the case of certain highly compensated employees, nondiscrimination requirements are met.

H.R. 907 would extend the definition of "de minimis" (and therefore not taxable) fringes to meals off the premises if certain conditions are met. Specifically: (1) the employer is unable to justify economically the operation of on-premise eating facilities, giving due consideration to capital and operating costs, (2) on-premise eating facilities are not provided at the actual place of employment of affected employees, (3) the meals are provided in kind, not in cash, and (4) the meals are furnished within a time frame with the employer's established meal schedule.

The bill is however unclear as to whether the "nondiscrimination" requirements that apply to other fringes defined as de minimus would also apply to "off the premises" facilities. Nondiscriminatory requirements should be clearly stated to assure against abuse. If nondiscriminatory language is included we believe the measure is appropriate and consistent with the intent of Congress in excluding "de minimis" fringes from taxation.

We therefore, support the enactment of H.R. 700 and H.R. 907 with appropriate nondiscriminatory language.

United Brotherhood of Carpenters and Joiners of America,
Shelby, AL, October 8, 1984.

Mr. John J. Salmon,
Chief Counsel on Ways and Means,
U.S. House of Representatives, Washington, DC.

Dear Sir: I would like to go on record in support of the above captioned bill. I am a union member of the United Brotherhood of Carpenters & Joiners of America.

It has been necessary for me to travel in order to maintain my trade. I have incurred great expense as a result. It is very unfair for the IRS to disallow our expenses when other people such as insurance salesmen, CPAs, and congressmen are considered temporially employed, and their expenses are allowed.

I am personally pursuing my own court case through the U.S. District Court in Birmingham with a trial by jury fighting this unfair practice. I feel this is the only way to win in this type of situation.

I hope this legislation (H.R. 700) will become law soon to correct this unjustifiable dilemna that the IRS has put on the American construction industry and its people.

Sincerely,

Stanley Ray Jones.

[From the Shelby County (AL) Reporter, Aug. 18, 1983]

EDITORIAL—CONSTRUCTION WORKERS GET SHORT END FROM IRS

Letter to the Editor:

The Internal Revenue Service is unfair to construction workers in the allowance of reasonable and necessary travel expenses.

It becomes necessary at times in a construction worker's life to travel to locations outside his local area of employment. This person may have lived in a given community for years. He has a home there, his children attend school there, he votes there and pays taxes there. His wife probably has a job in the same community.

All construction work is temporary in nature. If a construction worker takes a job a long distance from his home, he must either move his home and family to that job or incur substantial additional expense, either by traveling several miles each day or by renting temporary lodging near the job.

It is sometimes impossible or contrary to good business judgment to move near the job because of housing shortages, or the high costs of such housing. More important, construction work is inherently uncertain. Workers can be laid off with just two hours' notice.

Furthermore, the worker in this situation intends to work closer to his traditional work area as soon as a job is available. The worker has only two choices: remain unemployed, or incur travel expenses in order to practice his trade.

The IRS uses the so called "one year rule," (60-189) to disallow travel expenses, along with Rev. Rule 76-453 and 83-83. These rulings do not take into consideration all pertinent factors in dealing with each case. The result is harassment, loss of income and needless worry to many deserving workers. Congress has in the past disallowed implementation of some of these Rev. Rulings (76-453).

Why should construction workers not be able to claim the same "out of town" expenses that attorneys, CPA's, insurance salesmen and many others can claim that relate to business and mileage expenses?

Even Congressmen and Senators are considered temporarily employed and are allowed expenses.

There are currently five bills in Congress that will alleviate this problem. These are S-1352, S-1353, S-1219, H.R. 700 and H.R. 98. These bills, if passed, will settle the issue and correct the injustice the IRS has put on the construction worker.

I feel this situation has been around long enough, and workers of all construction crafts should band together and support the current legislation that's before Congress. Time is very short.

Write or call your Congressman and Senator at once.

Yours sincerely,

STANLEY RAY JONES, Shelby, AL.

98TH CONGRESS
1ST SESSION

H. R. 907

To amend Section 119 of the Internal Revenue Code of 1954 to provide that meals furnished by an employer to an employee may be considered furnished for the convenience of the employer if the meals are furnished on the business premises of the employer generally, except under certain conditions whereby meals may be furnished off the business premises of the employer.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 25, 1983

Mr. VANDER JAGT introduced the following bill; which was referred to the Committee on Ways and Means

---

A BILL

To amend Section 119 of the Internal Revenue Code of 1954 to provide that meals furnished by an employer to an employee may be considered furnished for the convenience of the employer if the meals are furnished on the business premises of the employer generally, except under certain conditions whereby meals may be furnished off the business premises of the employer.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. Section 119 of the Internal Revenue Code of 1954, subsection (a)(1) is amended by striking out and inserting in lieu thereof the following subsection:

"(1) in the case of meals, the meals are generally furnished on the business premises of the employer except as provided in subsection (b)(4) below, or"

SEC. 2. Section 119 of the Internal Revenue Code of 1954 is amended by adding at the end of subsection (b)(3) the following new subsection:

"(4) Furnishing of meals off the business premises of the employer as a matter of equity:

"(i) the employer is unable to justify economically the operation of on premise eating facilities giving due consideration to capital and operating costs;

"(ii) on premise eating facilities are not provided at the actual place of employment of affected employees;

"(iii) the meals are provided in kind, not in cash; and

"(iv) the meals are furnished within a time frame consistent with the employer's established meal schedule."

○

SUMMARY AND DESCRIPTION

PRESENT LAW

Present law excludes from gross income the value of meals furnished to an employee (or to the employee's spouse or dependents) by or on behalf of the employer for the convenience of the employer but only if the meals are furnished on the employer's business premises (sec. 119). If it is reasonable to believe that the employee will be able to exclude the value of a meal from income under section 119, then the value of the meal is not subject to social security or unemployment taxes (secs. 3121(a)(19), 3306 (b)(14)).

Under the Tax Reform Act of 1984, the value of meals provided to an employee at a subsidized eating facility operated by the employer is excluded from income and wages as de minimis fringes if (1) the facility is located on or near the employer's business premises, (2) revenue from the facility equals or exceeds direct operating costs, and (3) in the case of certain highly compensated employee's nondiscrimination requirements are met (sec. 132(e)(2), effective January 1, 1985).

EXPLANATION OF THE BILL

The bill would expand the section 119 exclusion to cover furnishing of meals off the employer's business premises if (1) the employer is unable to justify economically the operation of on-premise eating facilities, giving due consideration to capital and operating costs, (2) on-premise eating facilities are not provided at the actual place of employment of affected employees, (3) the meals are provided in kind, not in cash, and (4) the meals are furnished within a time frame consistent with the employer's established meal schedule.

EFFECTIVE DATE

The provisions of the bill would be effective on enactment.

REVENUE EFFECT

The provisions of the bill are estimated to decrease fiscal year budget receipts by $111 million in 1985, $194 million in 1986, $249 million in 1987, $287 million in 1988, and $320 million in 1989.

[NOTE.—See also statement of the AFL-CIO at p. 242.]

STATEMENT OF HON. BARBER B. CONABLE, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman and members of the Select Revenue Measures Subcommittee, I am pleased to be a co-sponsor of H.R. 907 which is before you today. This legislation would correct an inequity in the tax code which discrminates against small businesses in their ability to provide meals during the work day to their employees. It is difficult for such businesses to establish cafeterias within their actual business premises. Allocation of precious work space to an eating facility and making the investment necessary to equip and operate it are often beyond the means of a small business, particularly one which is in competition with larger enterprises. Thus, small businesses are disadvantaged vis-a-vis their larger counterparts.

H.R. 907 would permit employee meals to be furnished off the business premises with the same tax consequences present law provides for on-premises meals. A similar employee meal system has been successfully employed in ten countries of Western Europe and Latin America. The experience of these countries is that, in addition to the enhanced competitiveness of small businesses in terms of their ability to offer comparable benefit packages, the enactment of legislation similar to H.R. 907 has increased both sales and employment in the restaurant industry.

Accordingly, H.R. 907 presents your Subcommittee with a unique opportunity to both promote income tax equity among employees of various businesses and also to expand the food service industry and increase employment within that industry.

I welcome consideration of this legislation and I urge that it be reported favorably.

STATEMENT OF ROBERT E. JULIANO, LEGISLATIVE REPRESENTATIVE, HOTEL EMPLOYEES & RESTAURANT EMPLOYEES INTERNATIONAL UNION, AFL-CIO

On behalf of our general president, Edward T. Hanley, and the 400,000 members we proudly represent, we strongly endorse H.R. 907. Our union membership includes not only service personnel such as waiters, waitresses and bartenders, but also support personnel. Only ⅕ of our members are tipped employees, and industry experience shows that the ratio of service personnel to total employees is 0.4.

Notwithstanding our substantial current membership, the Hotel Employees and Restaurant Employees International Union enrolls more new members annually than any other union in the labor movement. This surprising statistic reflect the high turnover in the restaurant industry which ranges between 150 and 200 percent each year. In addition, approximately 75 percent of all restaurants fail during their first five years of operations. Each failed restaurant represents a loss of numerous jobs and, thus, has a devastating impact on the lives and livelihoods of our members. Because restaurants are concentrated in urban areas where there is often relatively high unemployment, these lost jobs are not easily replaced, particularly given that our restaurant workers are over 50 percent females and minorities which have traditionally suffered most in the job market.

Our union strongly supports H.R. 907 because we believe that it will not only create jobs in the restaurant industry but also enhance continuity of employment in the industry, so that those jobs which are created will also be retained. Because of the necessary and substantial expenditures for labor and perishable supplies, a restaurant must establish a steady client base in order to service. H.R. 907 will provide such a base, in that a restaurant will be able to arrange with nearby employers, either directly, or through a coupon voucher system, to make its facilities available for daily employee meals. These arrangements will benefit both the employer, who will be able to ensure that his employees receive a nutritious meal in a convenient location, thereby contributing to employee continuity and productivity, and the restaurant, which will obtain an expanded, and more importantly a predictable, clientele.

The average work week in the restaurant industry is approximately 27 hours. In 1982, the Treasury Department and Joint Committee on Taxation conservatively estimated that 0.4 percent of the U.S. workforce would take advantage of H.R. 907 when the system was fully in place (after five years). Using these estimates, the new business generated for the restaurant industry from implementation of the employee meal system would produce approximately 12,000 new jobs in that industry. If these estimates of workforce participation should be enhanced, there would be a proportionate increase in the number of restaurant industry jobs created by H.R. 907. There is a serious need for job security among our membership and in our industry, and because our industry is a major employer of women and minorities, such employment could be a major factor in combating this Nation's most difficult structural unemployment problems.

Because our union cares deeply about recurring unemployment in the restaurant industry and its impact upon our members, we strongly urge the members of this subcommittee and of the Committee on Ways and Means to report H.R. 907 favorably.

STATEMENT OF G. RICHARD SCHREIBER, PRESIDENT, NATIONAL AUTOMATIC MERCHANDISING ASSOCIATION

The National Automatic Merchandising Association (NAMA), the national trade association of the merchandise vending and contract food service management industry, is opposed to H.R. 907 introduced in the House of Representatives January 25, 1983 by Mr. Vander Jagt of Michigan.

NAMA represents more than 2,400 companies, most of which provide food and beverage service to employees of business and industry, hospitals, nursing homes, recreational facilities, and to the public generally and more particularly to students in secondary schools and colleges and universities. It is on behalf of these members that we speak in opposition to H.R. 907.

HISTORY OF THE CONVENIENCE-OF-THE-EMPLOYER RULE

Congress codified the convenience-of-the-employer rule in Section 119 of the Internal Revenue Code in 1954. It provides for the exclusion from the gross income of an employee the value of meals and lodgings furnished him, his spouse or dependents on the business premises of the employer for the employer's convenience.

At that time Congress retained, and has since left unchanged, the substantially identical definitions of "wages" for all three tax withholding obligations of employers, namely, income, FICA and FUTA taxes.

Following the codification, a number of problems have arisen over interpretations of the applicability of Section 119 by the Internal Revenue Service.

One recently settled by the U.S. Supreme Court in *Rowan* v. *United States* concerns the IRS position that the Section 119 exemption to gross income did not apply to wages under FICA and FUTA. The court held that the IRS erred in including in the computation of "wages" the value of the meals and lodging that the employer provided for its own convenience to its employees. Since gross income would include the narrower concept of wages, the court concluded that the Section 119 exemption applies to gross income as well as FICA and FUTA obligations.

Another troublesome issue was the interpretation by the IRS that if a charge were made for meals furnished employees for the convenience of the employer. The IRS held, therefore, that management fees paid by the employer to contract foodservice management companies for their preparing and selling employee meals would be considered part of the reasonable value of the meals and therefore subject to income, FICA and FUTA taxes and withholding. This interpretation was overruled by H.R. 12841 adopted in 1978 which amended Section 119 to state: "In determining whether meals are furnished for the convenience of the employer, the fact that a charge is made for such meals, and the fact that the employee may accept or decline such meals, shall not be taken into account." As a result, management fees and reimbursements paid to foodservice management companies providing foodservice to employees of a client on the premises of the client were no longer subject to inclusion as gross income to the employees. The *Rowan* decision would apply this limitation on the IRS to FICA and FUTA taxes also.

ARGUMENT IN OPPOSITION TO H.R. 907

The question of whether meals are furnished for the convenience of the employer generally depends on whether they are provided for substantial non-compensatory purposes. The exclusion of such meals from gross income of the employee is considered for the employer's convenience and not as an inducement or an employee benefit to the employee. It was not the intent of Congress to provide a tax shelter for the employee but to encourage ease of administration for the employer.

The current interpretation of the Section 119 exemption, as modified by the recent amendent and court decisions, now fully reflects this philosophy. It is our position that to further amend the section to include meals provided employees off the premises at public eating facilities could not be realistically regarded as for the convenience of the employer but could be considered an inducement or employee benefit for the employee and therefore readily arguable that the value of such meal is income to the employee. We conclude that if H.R. 907 were adopted it would undercut the underlying principle of the Section 119 income exemption for employees and could lead to a consideration for its total abolition from the code. This would be an obviously undesirable result both from the employer and employee point of view.

The extension of the tax exemption to employees for meals furnished off the premises of their place of employment provides a tax incentive that is counter-productive to the government's program of energy conservation. By providing meals to employees at the place of work, business and industry helps dissuade employees from leaving their place of work at mealtime, which is an important contribution to energy conservation. Congress has adopted a number of tax incentives to encourage energy conservation and now is not the time to use the code for a reverse effect. Our members stand ready to expand their food service to employees at their place of work and could readily cover workplaces that do not now provide such facilities. The merchandise vending and contract foodservice managment industry is making an important contribution to the government's energy conservation program and is able and willing to expand its program where needed.

CONCLUSION

The basic question is: How does furnishing meals to employees off the business premises of the employer serve the convenience of the employer? If the value of such meals is not to be included in the employees' gross income for tax purposes such a nontaxable employee benefit may serve equity when compared to the situation where meals are served employees on the business premises; but this is true only in the context of viewing such transactions as compensatory employee benefits. The whole purpose of Section 119 is to provide a convenience to the employer which in turn limits the choices of the employee and therefore is not regarded as compensation to the employee.

Finally, if meal service made available to employees on the business premises of business and industry is viewed as making an important contribution to the country's energy conservation program, and we think it does, then the tax laws should be structured to encourage on-premise consumption of meals. We suggest that the effect of H.R. 907 would be to the contrary.

For the reasons stated, the merchandise vending and contract foodservice management industry is opposed to the enactment of H.R. 907.

[Attachment]

SOCIETY FOR FOODSERVICE MANAGEMENT,
Louisville, KY, November 1, 1983.

Hon. DANIEL ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

DEAR CHAIRMAN ROSTENKOWSKI: The Board of Directors of the society for Foodservice Management has voted unanimously to join the National Automatic Merchandising Association in opposing H.R. 907 which we view as extremely detrimental to the interests of our membership.

The Society for Foodservice Management is the association representing the noncommercial segment of the foodservice industry, with especial emphasis on the business & industry sector. We represent all major contractors, as well as the majority of American businesses which elect to operate their own foodservice programs.

We ask you to consider that the National Restaurant Association, which is composed primarily of small independent restaurant operators and national foodservice chains, does not speak for the entire foodservice industry, and that there are other interested voices which should be heard in any consideration of H.R. 907.

Sincerely,

PHILLIP S. COOKE, *Executive Director.*

STATEMENT OF THE NATIONAL RESTAURANT ASSOCIATION

The National Restaurant Association is pleased to present the views of its membership concerning H.R. 907.

The National Restaurant Association is a business league whose almost 8,000 members consist of about 5,000 corporations and several thousand proprietorships and partnerships operating all types of foodservice establishments. Our membership includes affiliation with the restaurant associations of the 50 states which rely upon us to represent their views on issues raised by Federal legislation or regulation. We estimate that the foodservice industry in the U.S. includes over 561,000 restaurants and employs in excess of 5,000,000 people. After Government and medical and other health services, the foodservice industry is the country's leading employer. Moreover, the foodservice industry is a large employer of structurally unemployed: the current foodservice industry is the country's leading employer. Moreover, the foodservice industry is a large employer of structurally unemployed: the current foodservice industry workforce consists of 14 percent minorities and 29.1 percent teenagers.

The National Restaurant Association supports legislation before this subcommittee as H.R. 907. We believe that enactment of H.R. 907 will correct a major inequity in our tax laws and will have a direct effect upon the economic health and continued solid growth of the foodservice industry.

THE RESTAURANT INDUSTRY AND THE EMPLOYEE MEAL

Restaurant industry profile

The foodservice industry of this country consists of over 561,000 establishments. Over 388,000 of these are commercial operations and the remainder are operated by business, educational, governmental, or institutional organizations. Many of these establishments are owned and operated by small businessmen and businesswomen.

According to a National Restaurant Association survey, there are approximately 8 million men and women employed in all segments of the foodservice industry, of which about 5 million are directly engaged at the establishment level. This workforce at the establishment level represents approximately 5 percent of all employed persons in the United States. The census category of eating and drinking places alone, which accounts for about 67.3 percent of total foodservice industry sales, ranks second among all U.S. industries in employment behind medical and other health services.

The composition of the workforce in the industry is strongly oriented toward those segments of our society which are the most vulnerable to unemployment. The industry is labor intensive and is unique in the market it offers for unskilled, entry level employment. In weighting the economic and social effects of proposals that will increase employment in the industry, it is important to note that 65.7 percent or 3.1 million of the industry's employees are women; 29.1 percent of the industry's employees are teenagers (as compared with only 6.5 percent of all employed persons); and 14 percent are black or other minorities (as compared with only 11.8 percent of all employed persons).

Since it deals in the preparation of and sale of perishable products to individuals and groups on a personal service basis, the foodservice industry's demands for capital are equally intensive. For example, in 1981 table service restaurants required an investment per seat of $1,191 where the building and land is owned and an investment of $1,675 per seat, where the building is leased.

During the recent recession, profit margins for table service restaurants averaged 4.5 percent; down from 5.4 percent. Increases or decreases of sales have an immediate and substantial effect on the profit marign of our industry and on employment therein. To protect against the impact of future economic fluctuations, the foodservice industry now needs to stabilize its business to restore modest and reasonable profit margins and a steadily growing workforce.

The employee meal system

Section 119 of the Internal Revenue Code provides that meals furnished under certain conditions by an employer to an employee are not considered income to the employee. The cost of the meals provided by the employer may be either partially or totally borne by the employer without affecting the tax status of the employee. The critical test to be met is that the meals are furnished for the "convenience of the employer" and if so, they are tax-free. One of the conditions prescribed is that the meals must be provided on the employer's business premises, generally, in a company cafeteria.

Equity under the law

However, there is a major inequity under this law as it harshly discriminates against the employer who cannot provide a company cafeteria. There are hundreds of thousands of small business and even branch offices of larger companies which cannot provide on-premise eating facilities for their employees. These employers may not be able to make the capital investment required for a cafeteria. There may not physically be enough space available within the work premises to construct a cafeteria or it may be an inefficient use of work space as the employer seeks to expand his business. Finally, the cost of the cafeteria prepared and provided meal may exceed the economic capability of a small business concern.

By adoption of the employee meal system this inequity toward employees and employers of small and medium size businesses can be rightfully corrected. Moreover, conceptually, the employee meal system makes sense. The motivation for providing employees a nutritious meal each day during working hours is the same for the employer who is able to provide a company cafeteria for his employees and the one who is not—enhanced worker productivity, and promotion of greater safety and health on the job.

Experience in Western Europe and Latin America

The employee meal system exists today in ten countries of Western Europe and in Mexico, Brazil and Argentina. The laws respecting the employee meal sytem in these countries are very similar to that proposed. The system has enjoyed considerable success with over 2 million employee meals served per day in Western Europe.

Operation of the employee meal system

The system is designed to allow any employer to provide his employees with an "in-kind" meal to be consumed during the work day, normally at lunch, the cost of which may be partially paid by the employer and partially by the employee for a sharing in the cost by each. The tax treatment would be the same as for the company cafeteria. Amounts contributed by the employer would not be deemed income to the employee. Of course, the employee cost participation is in after tax dollars. This meal cost-sharing would be equally available to all employees and employers. Payments of currency to the employee would not be permitted, and the employee meal would not be transferable from one employee to another or to anyone else. Only bona-fide, employment related meals would be allowed with a specific prohibition against the purchase of liquor or tobacco.

This system would enable the employer to use of the following procedures. He could contribute together with other employers in the same building or neighborhood toward the cost of a shared cafeteria operated in the same manner as the typical company cafeteria. He could establish a direct account with one or more predetermined eating establishments in the immediate vicinity of his business and allow his employees to choose any of those subscribing establishments for his meal. Only the daily amount agreed upon by the employer and employee could be spent. Thus, the value of the meal might be $4.00—$2.00 paid by the employer and not treated as income to the employee and $2.00 paid by the employee and deducted from his wages. An alternative approach could be through the use of special identification cards issued by the employer which would be presented for payment in the form of a charge to the employer's employee meal account. A final alternative would be to parallel the system most widely used in ten countries of Western Europe and Mexico, Brazil and Argentina, which relies primarily upon the use of meal vouchers or coupons of differing values. The voucher or coupon books are issued by the employer on a weekly or monthly basis and are exchanged in payment for the meal consumed at the participating eating establishment. The coupons collected by the restaurant would in turn be redeemed for payment by the employer. In summary, the participants in the system are the employer, the employee, the eating establishment and, as may be the case, an outside company which issues the vouchers or coupons.

The concept is simple and straightforward. The employee meal provides equity and promotes productivity and employee health and safety. The economic benefits are substantial relative to structural unemployment and small business expansion.

Revenue estimates

Revenue estimates provided by the Treasury Department and Joint Committee on Taxation in 1982 which did not consider feedback revenues, show a static revenue loss of $72 million in 1987 when the system is assumed to be fully implemented. Based on the assumption used in this 1982 Treasury/Joint Tax Committee estimate that .4 percent of the then-total United States workforce of 109.7 million would participate in the employee meal system by 1987, the National Restaurant Association data shows that $339 million in sales of which $288 million represents new business for eating establishments across the country would result from enactment of H.R. 907. The National Restaurant Association estimates that the total Federal and state revenue consequence considering Federal income and employment tax revenues lost by virtue of the proposed amendment, Federal income and employment tax revenues gained from tax receipts on increased industry sales and taxes paid by new employees, and state sales taxes gained and unemployment benefits saved is an $11.1 million revenue gain overall. This gain is directly proportional to the static revenue loss assumption since it is generated by the expenditure of the exempt employer contributor. Thus, increased static revenue loss estimates would lead to increased net revenue gains to this feedback effect.

Job creation

Based upon an estimated $28 million of new business in the foodservice industry, attributable to the employee meal, new jobs in our industry would total 7,900 based on a 40-hour week and almost 12,000 based on the average restaurant industry work week of 27 hours. Since the current foodservice industry workforce consists of 14 percent minorities and 29.1 percent teenagers, it is likely that these new jobs will be an excellent source of employment for the structurally unemployed, a critical factor in view of the current 42% minority teenage unemployment rate. Further, as with the revenue figures discussed above, these job creation statistics are directly proportional to the revenue loss assumption and increase in tandem with those assumptions.

If feedback effects are considered, the employee meal system produces even more favorable results. First, if feedback-type employment effects are considered, it is the experience of the National Restaurant Association that each additional industry job creates a second job in a related field to produce the additional food or supplies. Thus, the actual number of jobs crated overall attributable to the employee meal system could be twice the 12,000 estimated industry jobs. Second, if total feedback revenues are considered, for each additional industry job created by the employee meal system, there would be a revenue savings of $945.

Enactment of H.R. 907 will not only correct an inequity in our Tax Code, it will also increase business in the foodservice industry and create new employment opportunities.

STATEMENT OF HON. GUY VANDER JAGT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. Chairman and colleagues of the Select Revenue Measures Subcommittee, over four and one-half years ago I introduced the legislation now before you as H.R. 907 to correct a long overlooked inequity in our income tax laws.

Section 119, the so-called company cafeteria section of the Internal Revenue Code, presently allows the cost of meals furnished under certain conditions by an employer to his employees not be considered income to the employees and, hence, not taxable to them. One of the principal criteria under present law is that the meals be provided on the business premises of the employer, generally in a company cafeteria.

This requirement harshly discriminates against those employees and employers who cannot provide company cafeterias. There are hundreds of thousands of small businesses and even branch offices of larger companies which are unable to make available on-premises eating facilities for their employees. While these employers wish to enhance their employees' productivity, health, and safety by providing a meal for them on their business premises, they simply cannot for lack of adequate space or for economic reasons as they may not be wealthy enough to afford the costs of construction and operation of a company cafeteria.

In testimony before this Subcommittee on September 17, 1984, the Treasury Department expressed its concern "that the tax benefits derived from the existing statutory fringe benefits are not fairly distributed among taxpayers." Such horizontal inequity would be alleviated by enactment of H.R. 907 which would enable small and medium size businesses to offer their employees a benefit now restricted to employees of larger businesses.

In these types of instances it is simple tax equity that an employer should not be denied the right to provide meals during the work day off his premises if he deems it in his business interest to do so.

This bill corrects this inequity by allowing the meal to be furnished "directly or indirectly in kind"—meaning the meals may be furnished on or off the business premises of the employer but that cash may not be provided by the employer for the purchase of the meals.

The concept is simple. Where a company cafeteria exists, the meals are provided there. Where it is not possible or not economically feasible for the employer to provide a company cafeteria, the meal could be consumed in a nearby eating establishment or in a shared company cafeteria. Payment for the meal could be by direct contract between the employer and a foodservice establishment with an accounting system agreeable to the parties or by the use of a coupon system. As with the company cafeteria, the plan would be available to all employees who wish to participate, and meals would be consumed only during the work day. I should also point out that this concept follows closely that allowed under the law in 10 countries of Western Europe and Latin America, including West Germany, France, and the United Kingdom.

In addition to the compelling tax equity reasons for this amendment, I am greatly encouraged by the economic results forecast in connection with the implementation of this concept. Economic analyses developed by the restaurant industry and the National Restaurant Association project an increase in foodservice sales of 288 million dollars annually coupled with the creation of 12,000 new jobs in the restaurant industy.

This estimate of new jobs is particularly important as they are a principal source of employment for the structurally unemployed. Foodservice industry employment today consists of 14 percent minorities and 29.1 percent teenagers. With the shockingly high current minority teenage unemployment rate of 41.7 percent, this new job market should help alleviate the severe structural unemployment problem in the United States today.

Mr. Chairman, this Subcommittee and the Committee on Ways and Means have combatted discrimination in fringe benefits among employees at varying level jobs. This legislation would prevent discrimination in fringe benefits among employees of varying sized businesses. This legislation serves the interest of tax equity, small business and "the little guy" and, therefore, I urge my colleagues on the Subcommittee to report this measure favorably.

I

98TH CONGRESS
1ST SESSION

H. R. 1343

To amend the Internal Revenue Code of 1954 to treat mutual banks having capital stock represented by shares in the same manner as other mutual banks for purposes of the bad debt reserve deduction.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 8, 1983

Mr. LOWRY of Washington introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to treat mutual banks having capital stock represented by shares in the same manner as other mutual banks for purposes of the bad debt reserve deduction.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subparagraph (B) of section 593(b)(2) of the Internal Revenue Code of 1954 (relating to addition to reserves for bad debts) is amended by striking "which is not described in section 591(b)" each place it appears.

(b) Subparagraph (C) of section 593(b)(2) of such Code is amended by striking "which are not described in section 591(b)".

(c) The amendments made by this section shall apply with respect to taxable years ending after the date of the enactment of this Act.

SUMMARY AND DESCRIPTION

PRESENT LAW

Under present law (sec. 593), mutual savings banks, savings and loan associations, and certain other financial institutions ("thrift institutions") can deduct from taxable income a reasonable addition to their reserves for losses on qualifying real property loans (such as home mortgages). The amount so added to a reserve for such losses cannot exceed the largest of three amounts determined under three separate methods—the percentage of taxable income method (sec. 593(b)(2)), the percentage method applicable to banks (sec. 593(b)(3)), and the experience method (sec. 593(b)(4)).

The amount determined under the percentage of taxable income method generally cannot exceed 40 percent of the taxpayer's taxable income for the year. However, because the deduction under section 593(b) is designed in part to encourage financial institutions to provide real property loans, the percentage of taxable income determined under paragraph (2) is reduced to the extent that an insufficient percentage of the taxpayer's holdings consist of real property loans and certain other assets (such as cash) described in section 7701(a)(19)(C) ("qualified property").

In the case of mutual savings banks that do not have capital stock represented by shares, at least 72 percent of total assets must be qualified property in order for the addition to the bad debt reserve, as determined under section 593(b)(2)(B), to equal 40 percent of taxable income for the year. If less than 72 percent of their assets are qualified property, then the 40-percent cap on the addition to the bad debt reserve is reduced by 1½ percentage points for each one percentage point by which an insufficient proportion of total assets so qualify.

A more stringent rule regarding the holding of real property loans applies to all other thrift institutions (including mutual savings banks that have capital stock represented by shares). For these institutions, the full 40-percent cap applies only if at least 82 percent of total assets are qualified property. For each one percentage point by which an insufficient proportion of assets so qualify, the 40-percent cap is reduced by ¾ of 1 percentage point.

EXPLANATION OF THE BILL

Under the bill, mutual savings banks that have capital stock represented by shares would be treated like other mutual savings banks, rather than like all other thrift institutions, for purposes of the permissible addition to bad debt reserves under the percentage of taxable income method. Thus, only 72 percent of the total assets of a stock mutual savings bank, rather than 82 percent as under present law, would have to be qualified property in order for the 40-percent cap, rather than a reduced cap, to apply.

EFFECTIVE DATE

The bill would apply to taxable years ending after the date of enactment.

REVENUE EFFECT

The provisions of the bill are estimated to decrease fiscal year budget receipts by less than $50 million annually.

STATEMENT OF CHASE MANHATTAN BANK, N.A.

Mr. Chairman and Members of the Subcommittee; we are pleased to submit this statement as part of your hearings of October 3, 1984 on H.R. 1343, a bill designed to address certain alleged inequities in the bad debt reserve tax deductions afforded stock savings banks in comparison to the deductions that are available to mutual savings banks. Chase applauds your Committee's consideration of H.R. 1343 as a healthy indication that the area of bad debt reserve allowances for financial institutions is now being assessed and reviewed.

The bad debt reserve rules currently contained in the Internal Revenue Code (the "Code") are permeated with anomalies and flaws such as those sought to be corrected by H.R. 1343. Chase is greatly concerned with the bad debt reserve rules, and in particular those governing allowances for commercial banks because the current Code provisions do not provide an adequate measure for an addition to their loan loss reserves. Members of both tax writing Committees have taken increasing notice of this problem and have introduced legislation [1] designed to correct the flaws of the current statutory scheme. As is made clear by the discussion in the body of our statement, these issues, like the ones raised by H.R. 1343, merit prompt Congressional attention and should be viewed as part of the larger question of proper loss reserve rules for all financial institutions.

Statutory background

The Tax Reform Act of 1969 established the current framework for computing bad debt reserves of commercial banks. That Act provided two alternative measures for an addition to the loan loss reserve. Under the first, the "percentage of eligible loans" methods, an addition to the reserve for bad debts was allowable to the extent sufficient to increase the reserve to a specified percentage of eligible loans. For taxable year 1982, the specified percentage was 1.0 percent, and for years 1983 to 1987 the specified percentage is 0.6 percent As of 1988, the percentage of eligible loans method will be phased out completely, and will no longer be available to commercial banks to compute their deductions for additions to bad debt reserves. For years beginning after 1987, commercial banks will be limited strictly to the second alternative, the "experience method," which represents a statutory codification of the "*Black Motor* case" formula.[2]

Under the experience method, the reserve addition is based on a six-year moving average so that the amount added to reserves in a given taxable year is a function of actual bad debts in the immediately preceding five taxable years. Non-bank corporate taxpayers are permitted by statute to make use of other methods to calculate their bad debt reserve if the *Black Motor* formula yields an unreasonable results. By contrast, commercial banks are currently compelled to use the *Black Motor* formula in the event they elect not to use the percentage method, and after 1987, it will be the only available method.

Defects in the current statutory scheme as it relates to commercial banks

The statutory scheme under which commercial banks operate is clearly deficient in providing for reasonable bad debt reserves. The percentage method, which until recently produced some measure of fairness, has been phased down to a level (0.6 percent) that simply does not comport with experience in the industry. Moreover, even this percentage phases out in 1987, leaving banks only the *Black Motor* method. Unfortunately, however, the *Black Motor* formula cannot yield a consistently sound result for banks given the assumptions of the formula and the nature of their business.

The *Black Motor* formula has been the subject of considerable general criticism since its recognition by the Board of Tax Appeals.[3] Without attempting to formulate a complete list of the formula's frailties, the discussion below will focus on some of its more glaring deficiencies when applied to banks.

First, banks have historically experienced considerable growth in the size of their outstanding loan portfolios and in the amount of their bad debt experience, trends which have accelerated in recent years. In particular, the bad debt experience of banks has shown tremendous volatility, as evidenced by chart A attached to this statement. When the *Black Motor* formula is applied to banks, these trends collide with the rigid presumptions in the formula that the size of loan portfolios and the level of bad debt experience are static over time. Thus, as illustrated on charts B-I and B-II attached to this statement, the formula will dramatically underprovide for prospective bad debts in the case of banks, because its underlying assumptions of static loan portfolios and bad debt levels are generally incorrect.

These assumptions are not, however, the only fundamental conceptual flaws in the formula with especially harsh application to banks. The *Black Motor* method is also premised on the assumption that loans during the six-year experience period will have a one-year life. For banks, which typically have loan portfolios with lives in excess of one year, the formula yields faulty results.

Charts B-III and B-IV graphically illustrate the virtual meaninglessness of the formula in the situation where loans extend beyond one year. Chart B-III illustrates the fairly rare situation where the loan portfolio does indeed have an average one-year life and where other factors are static. In this situation, of course, the formula produces a reasonable addition and an adequate reserve because this is the precise situation that the formula was designed to reflect. By contrast, however, Chart B-IV illustrates that even where the loan portfolio and bad debt experience are static, the experience method dramatically understates adequate reserves for a portfolio with an average life in excess of one year.

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[1] See H.R. 4551, introduced by Representative Jake Pickle (D. Tex.) and Bill Frenzel (R. Minn.); and S. 1509, introduced by Senators William Roth (R. Del.), Steve Symms (R. Idaho), and Lloyd Bentsen (D. Tex.), both of which were introduced in the first Session of the Ninety-eighth Congress.

[2] This method, set forth in section 585(b)(3) of the Code, is derived from the decision in *Black Motor Co.*, 41 B.T.A. 300 (1940), *acq.* 1940-1 C.B. 1, aff'd on another issue, 125 F2d 977 (6th Cir. 1942).

[3] See, e.g., Whitman, Gilbert, and Picotte, "The *Black Motor* Bad Debt Formula: Why It Doesn't Work And How To Adjust It," J. Tax. 366 (December 1971).

The *Black Motor* concept is critically deficient in at least one other respect that is particularly detrimental to banks. The banking industry, perhaps more than any other, is vulnerable to the effects of a severe economic downturn or recession. The *Black Motor* formula is utterly retrospective in its application, and permits no consideration whatsoever of the anticipated future economic climate. This inflexibility in the formula, which requires banks to anticipate the future contingency of losses on loans without reference to evidence of future trends, only makes the *Black Motor* formula's results more unrealistic, and even heightens the exposure of banks to the consequences of economic events.

Even the supposed objectivity of the *Black Motor* formula, used by many to defend its application, is illusory given the fairly common controversy between taxpayers and the I.R.S. over the factors entering into it. For example, the issues of the timing and amount of actual loan losses must be resolved in actually applying the formula, and each introduces an element of subjectivity into the calculation.

All of the defects described above are, of course, in some measure relevant for non-bank taxpayers who must also grapple with the *Black Motor* formula; indeed, the sum total of these flaws suggest that the application of the formula can be seriously questioned in the case of many corporate taxpayers—not just commercial banks. There is a critical difference, however: taxpayers other than commercial banks have at least some flexibility because the Code does not actually impose the formula on them. The Code allows for deductions of "reasonable" additions to reserves and the implementing regulations clearly envision case-by-case, year-to-year, and industry-by-industry flexibility based on facts and circumstances in calculating reasonable additions.[4] By contrast, for commercial banks the formula is mandated without modification, except in the limited circumstance of approval by the Service of a shorter time period to measure experience. But this limited exception does nothing to correct the structural defects in the formula, described above. This result is anomalous because the nature of the loan portfolios and bad debt experience of commercial banks makes strict application of the *Black Motor* formula even less appropriate than in the case of other corporate taxpayers.

The necessary statutory revisions

The solution to the structural flaws and historical bias of the current loan loss reserve rules is twofold. First, the percentage of eligible loans method should be made a permanent feature of the Code, with the percentage set at 1.0 percent. This level is generally acknowledged within the industry, and by the Comptroller of the Currency and the Federal Deposit Insurance Corporation,[5] as the appropriate level for bad debt reserves. Because a 1.0 percent level roughly conforms with the average reserve maintained on the books of account of many, if not most, banks, it provides no tax expenditure, preference or subsidy. A fixed percentage set at 1.0 percent can thus be viewed as a safe haven at the proper level of magnitude with the virtues of simplicity and some relative ease of administration. Moreover, given the industry-wide experience on bad debts, it produces a more accurate result than the *Black Motor* formula itself.

Second, the *Black Motor* formula should be recrafted to take into account factors which it does not presently reflect: *e.g.*, growth in loans, bad debt experience, and receivables of longer terms than one year. Chase and others are currently giving active consideration to technical modifications to the *Black Motor* formula. We are mindful, however, that the formula can never be made to reasonably reflect the situation of all banks under all circumstances. No mechanical formula can accomplish that task. We, therefore, believe that a most critical modification to the loan loss rules for commercial banks would be to put them on parity with other corporate taxpayers by permitting deviations from any mechanical formula upon a showing of "facts and circumstances" which justify a departure from the formula's strict application. A bank, like other corporate taxpayers, should be allowed the opportunity to establish, in the face of the Internal Revenue Service's presumption of correctness, that a reserve addition is reasonable even though not based upon or derived from the *Black Motor* formula.

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[4] Section 166(c) of the Code; Reg. § 1.166–4(b).

[5] Letters from C.T. Conover (Comptroller of the Currency) and from William M. Isaac (Chairman of the Federal Deposit Insurance Corporataion) to Congressman Bill Frenzel (R. Minn.) (July 27 and 23, 1982).

SUMMARY AND CONCLUSION

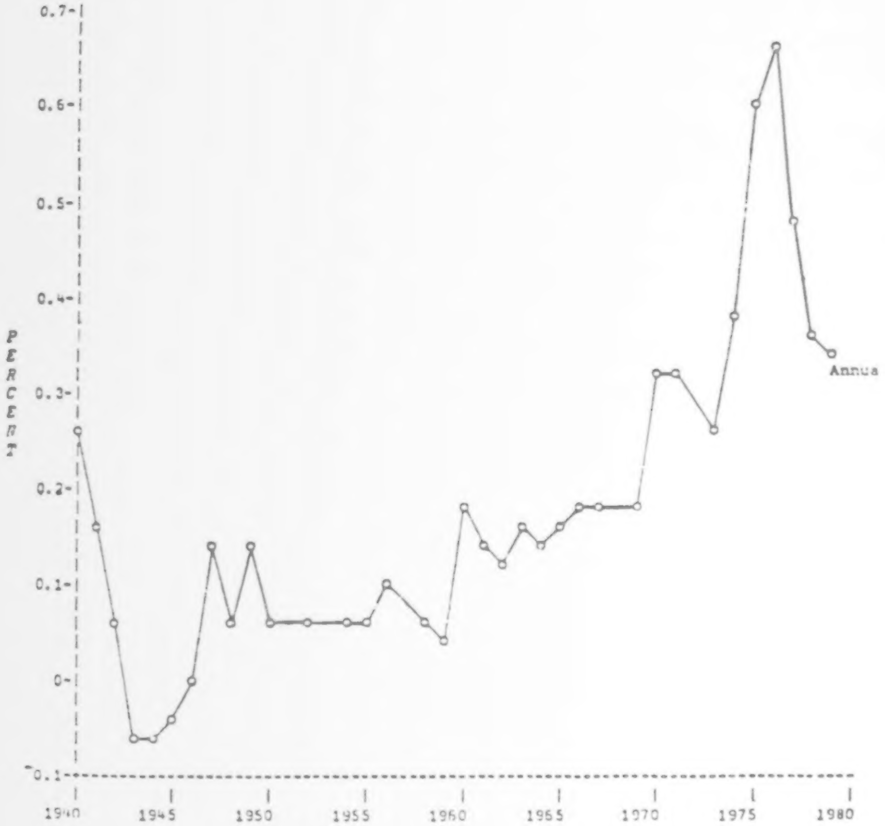
We commend this issue to the attention of the Committee as one in need of prompt attention. Even if the serious defects of *Black Motor* are avoided by electing to take the percentage method available through 1987 under present law, the current level for the percentage method of 0.6 percent is clearly inadequate to the task, given the experience of the banking industry as a whole. Thus, many commercial banks are presently faced with a Hobson's choice between the inadequate percentage method and the arbitrary and often unreasonable results obtained under *Black Motor* formula. Moreover, the worst possible outcome would be for the banking industry to face 1988 and all later years locked into the inflexible application of the *Black Motor* formula.

We strongly urge that the percentage method be maintained and set at a reasonable level of 1.0 percent for banks, and that the structural defects of the *Black Motor* formula be eliminated to the extent possible. Lastly, banks must be given the opportunity to determine their reserves by reference to facts and circumstances in those instances in which the *Black Motor* formula yields an unreasonable result.

CHART A

LOAN LOSS RATES

(1940-1979)



SOURCE: FDIC Annual Reports, various issues.

CHART B-I.—ILLUSTRATION OF UNDERPROVISION FOR BAD DEBTS EXPERIENCE METHOD—RISING LOAN GROWTH

	Experience years						
	1 (a)	2 (b)	3 (c)	4 (d)	5 (e)	6 (f)	1 thru 6 (g)
(1) Loans—1 yr life	100	200	300	500	700	1,000	2,800
(2) Bad debts (5 percent of prior year's loans)		5	10	15	25	35	90
(3) Bad debt experience ratio: (Item (2) / item (1))							.032
(4) Propspective bad debts in portfolio based on formula: (Item (1) col. (f) × item (3))							32
(5) Prospective bad debts actually in portfolio: (Item (1) col. (f) × 5 percent)							50
(6) Underprovision for prospective bad debts: (Item (5) — item (4))							18

CHART B-II.—ILLUSTRATION OF UNDERPROVISION FOR BAD DEBTS EXPERIENCE METHOD—RISING BAD DEBT GROWTH

	Experience years						
	1 (a)	2 (b)	3 (c)	4 (d)	5 (e)	6 (f)	1 thru 6 (g)
(1) Loans—1 yr life	100	200	300	500	700	1,000	2,800
(2) Bad debts (various percent of prior year's)		(5%) 5	(5%)10	(10%) 30	(10%) 50	(15%) 105	200
(3) Bad debt experience ratio (Item (2) / item (1))							.071
(4) Prospective bad debts in portfolio based on formula: (Item (1) col. (f) × item (3))							71
(5) Prospective bad debts acutally in portfolio (Item (1) col. (f) × 15 percent [1]							150
(6) Underprovision for prospective bad debts (Item (5) — item (4))							79

[1] Bad debt losses in yr 7 should be at least equal to 15 percent rate in yr 6.

CHART B-III.—ILLUSTRATION OF REASONABLE ADDITION TO BAD DEBT RESERVE EXPERIENCE METHOD, 1-YEAR LOANS AND STATIC OTHER FACTORS

	Experience years						
	1 (a)	2 (b)	3 (c)	4 (d)	5 (e)	6 (f)	1 thru 6 (g)
(1) Loans—1 yr life [1]	100	100	100	100	100	100	600
(2) Bad debts (5 percent)	5	5	5	5	5	5	30
(3) Bad debt experience ratio: (item (2) / item (1))							.05
(4) Prospective bad debts in portfolio based on formula (Item (1) col. (f) × item (3))							5
(5) Prospective bad debts actually in portfolio: (Item (1) Col. (f) × (5 percent)							5
(6) Underprovision for prospective bad debts: (Item (5) — item (4))							0

[1] Loans represent six $100 loans with maturity of 1 yr.

CHART B–IV.—ILLUSTRATION OF UNREASONABLE ADDITION TO BAD DEBT RESERVE EXPERIENCE METHOD, 6-YEAR LOAN AND STATIC OTHER FACTORS

	Experience years						
	1 (a)	2 (b)	3 (c)	4 (d)	5 (e)	6 (f)	1 thru 6 (g)
(1) Loan—6 yr life [1]	100	100	100	100	100	100	600
(2) Bad debts (5 percent over life)	1		1	1	1	1	5
(3) Bad debt experience ratio (Item (2) ÷ item (1))							.008
(4) Prospective bad debts in portfolio based on formula (Item (1) col. (f) × item (3))							.80
(5) Prospective bad debts actually in portfolio (Item (1) col. (f) × 5 percent) [2]							5
(6) Underprovision for prospective bad debts (Item (5) − item (4))							4.20

[1] Loan represents one $100 loan with maturity of 6 yr.

[2] The 5 percent loss on the replacement loan portfolio at end of yr 6 will be realized over the life of that loan, i.e., over its 6-yr life and not necessarily in the next year.

STATEMENT OF THE U.S. LEAGUE OF SAVINGS INSTITUTIONS

The U.S. League of Savings Institutions[1] which represents savings banks and savings and loan institutions with both stock and mutual ownership, appreciates this opportunity to present its views to the Subcommittee in strong support of H.R. 1343 introduced by Cong. Mike Lowry (D-Wash.). This important legislation attempts to rectify an inequitable change in the qualified asset test of savings banks adopted during the conference negotiations on the Economic Recovery Tax Act of 1981 (ERTA).

The change requires a stock savings bank to invest at least 82 percent of their assets in residential real estate, liquidity and certain other assets in order to receive the full benefit of Section 593(b)2—the percentage of taxable income method bad debt deduction. It was 1962 when mutual savings banks were first made eligible for the percentage of taxable income bad debt deduction. Then in the Tax Reform Act of 1969, Congress, believing Section 593(b)(2) had become too generous, cut back this tax benefit for savings banks and savings and loans by 33 percent over a ten-year period.

At the same time Congress was reducing the benefits of Section 593(b)(2), it also reaffirmed the rationale for this important tax benefit—to provide a major source of home mortgage loans.

Under the 1969 Act, the 82 percent investment test which qualified savings and loan institutions for the full 593 tax benefit was expanded to include mutual savings banks at a lower 72 percent qualifying loan level. The reason for the more lenient test for savings banks was due to the broader asset powers already enjoyed by these institutions. By requiring the 72 percent qualifying loan test for mutuals, Congress hoped to encourage greater housing-related residential real estate investment, while at the same time allowing them the investment flexibility necessary to effectively compete in the highly competitive financial marketplace.

Stock savings bank test creates competitive disadvantage

Savings banks have traditionally been limited to a mutual form of ownership. In 1980, Congress gave mutual savings banks the authority to convert to stock ownership. The following year the ERTA law made stock savings banks eligible for Section 593 tax treatment but applied the more rigid 82 percent qualifying asset test required by savings and loans. If stock savings banks meet the critical investment test which has been required of their mutual counterparts for the last 15 years, then what justification is there for not according them the same favorable tax treatment?

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[1] The U.S. League of Savings Institutions serves more than 3,500 member institutions which make up the $900 billion savings association and savings bank businesses. League membership includes all types of institutions—federal and state-chartered, stock and mutual. The principal officers include: Paul W. Prior, Chairman, New Castle, Indiana; John B. Zellars, Vice Chairman, Atlanta, Georgia; William B. O'Connell, President, Chicago, Illinois; Philip Gasteyer, Executive Director of Washington Operations; and Rita I. Fair, Senior Vice President, Regulatory Operations. League headquarters are at 111 East Wacker Drive, Chicago, Illinois 60601. The Washington Office is located at 1709 New York Avenue, N.W., Washington, D.C. 20006. Telephone: (202) 637-8900.

Equity requires equal treatment between similar institutions. Stock savings banks have the same methods of operation, authority and powers as mutuals. Consequently, there is no inherent structural reason why stock savings banks should be subjected to the more restrictive 82 percent test. Therefore, by subjecting stock savings banks to the restrictive 82 percent qualifying asset test, you place those institutions at a competitive disadvantage vis a vis mutuals. A competitive disadvantage which is based on form rather than substance. By contrast, all savings and loan institutions are required to meet the same 82 percent test whether they're stock or mutual.

Stock savings bank test inconsistent with 1969 Reform Act

The 82 percent savings bank test is also inconsistent with the 1969 Tax Reform Act which established the asset test distinction between savings banks and savings and loans based on traditional differences in investment powers and loan portfolios, not their form of ownership. H.R. 1343 corrects this inequitable distinction and the U.S. League supports this result.

Stock savings bank test discourages conversion

The 82 percent qualifying test also acts as a disincentive to stock conversion at a time when many undercapitalized mutuals are exploring ways to attract new sources of capital.

The thrift industry has been devastated in recent years by high interest rates. Their traditional long-term low-yielding residential mortgage loan protfolios, generated under Sec. 593(b)(2), have undermined the ability of thrifts to quickly and profitably adapt to today's high interest rate environment. This growing pressure from high interest rates has caused thrifts to experience the largest number of failures and forced mergers since the depression years. Also the enactment of federal programs, like the net worth certificate program in 1982, which bolsters the net worth of weakened thrifts, have been most helpful to the struggling thrift industry.

Unfortunately, high interest rates are not a passing phenomenon but are expected to continue to plague the business recovery for the foreseeable future. In response to this bleak economic forecast, the U.S. League believes it's appropriate to reduce the investment restrictions of stock savings banks and work to strengthen their net worth and captital base. An important way of achieving this is by providing a stock conversion option which doesn't inhibit savings bank investment alternatives. Consequently, the League supports changing Section 593(b)(2) as proposed in H.R. 1343 because it corrects the arbitrary distinction that the current tax code creates between mutual and stock savings banks, thereby eliminating a major impediment to stock conversion.

The 82 percent test also stiffles savings and loan investment flexibility

Just as stock savings banks should not be bridled with new investment restrictions in this period of shrinking earnings and high interest costs, the 82 percent savings and loan qualified asset test imposes an outdated mortgage investment standard which should be eased. The 82 percent qualified asset test for savings and loans was first applied after the Revenue Act of 1962. It was an investment standard developed during the economic stability of the early 1960's and was appropriate for its time, reflecting stable interest rates, low inflation and a strong demand for housing. Since 1962, housing finance has certainly undergone dramatic changes including sharp interest rate increases, additional mortgage competitors and new innovative mortgage instruments. The 82 percent test, first applied in the stable economic period of the 1960's, is no longer an appropriate standard for the 1980's. The rigid mortgage investment percentage of Section 593(b)(2) discourages alternative investment opportunities specifically enacted in 1982 for the purpose of strengthening the capital position of thrift institutions—so that they remain viable in the future to perform their role as the nation's principal source of home mortgage credit.

Savings and loans have performed their special home lending function with great distinction over the years. The tax incentive provided by Sec. 593(b)(2) has been principally responsible for directing over $645 billion of savings and loan assets into qualifying loans (Sec. 7701(a)(19)(C)). No less than 85 percent of federally-insured savings and loan institutions maintain $564 billion or over 72 percent of their assets in these qualifying loans. The savings and loan business is proud of their record of providing homeownership opportunity to America for the past one-hundred and fifty years and is committed to continuing this important task in the years ahead.

Now after 22 years and tremendous upheaval in the financial marketplace, it is time to revise the 82 percent standard to a more realistic mortgage investment level consistent with new limited, but broadened powers. If this change were made, savings and loans would be in a better position to strengthen net worth and improve capitalization, making them more active and productive mortgage lenders. The U.S. League strongly recommends that the lower savings bank test (72 percent test) be applied to all thrifts.

Federal policy should encourage viable competitive thrifts

Two years ago Congress enacted major financial institutions legislation which granted new but limited investment authority for thrift institutions. This landmark Garn-St Germain legislation narrowed, but by no means eliminated, the distinctions within the U.S. financial community.

The underlying federal policy of the Garn-St Germain legislation was to improve the competitiveness and thus the viability of thrifts. Consequently, relaxing the restrictive and outdated savings and loan qualified asset test is clearly in concert with the policy enunciated in the Garn-St Germain Act of making savings and loans stronger financial competitors and more productive home lenders. Savings and loan institutions want to continue their traditional commitment to housing finance, but realize that today's volatile interest rate savings will demand additional investment flexibility for institutions to remain viable, healthy and productive mortgage lenders. Therefore, the U.S. League proposes that the 72 percent qualified asset test should apply to all thrifts whether they be savings banks or savings and loans, mutuals or stocks.

The U.S. League of Savings Institutions appreciates the opportunity to present is views on this important issue contained in H.R. 1343.

I

98TH CONGRESS
1ST SESSION

H. R. 1773

To amend the Internal Revenue Code of 1954 with respect to the unrelated business taxable income of certain nonprofit charitable organizations.

IN THE HOUSE OF REPRESENTATIVES

MARCH 2, 1983

Mr. DUNCAN (for himself and Mr. GUARINI) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 with respect to the unrelated business taxable income of certain nonprofit charitable organizations.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 513 of the Internal Revenue Code of 1954 (relating to unrelated trade or business) is amended by adding at the end thereof the following new subsection:

"(h) EXCHANGES, RENTALS, AND SALES OF NAMES FROM DONOR LISTS OR MEMBERSHIP LISTS.—In the case of an organization described in section 501 contributions to which are deductible under section 170, the term 'trade or business' does not include any trade or business of such organization which consists of exchanging, renting, or selling names and addresses of donors to, or members of, such organization."

(b) The amendment made by subsection (a) shall apply to taxable years ending after the date of the enactment of this Act.

SUMMARY AND DESCRIPTION

PRESENT LAW

General rule

Under present law, certain organizations are generally exempt from Federal income tax because of their charitable, eductional, religious, or other nonprofit purposes and functions. However, in light of examples of tax-exempt organizations which had been acquiring and operating, on a tax-free basis, businesses unrelated to their exempt purposes or functions, the Congress enacted the unrelated business income provisions in 1950. These provisions (Code secs. 511–514) impose a tax on the unrelated business income of exempt organizations, primarily in order to remove any unfair advantage which tax-exempt organizations otherwise would have over taxable competitors (S. Rep. No. 2375, 81st Cong., 2d Sess. 28–29 (1950)).

The tax applies to gross income derived by an exempt organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business, both subject to certain modifications. Under one such modification (sec. 512(b)(2)), dividends, interest, annuities, royalties, and, generally, rents from real property are exempted from the tax. Also, there are special rules with regard to rents from personal property leased with real property.

Definition of unrelated business

Under present law, an unrelated trade or business is defined as any trade or business of a tax-exempt organization the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, religious, or other nonprofit purpose and function constituting the basis for its exemption (sec. 513(a)).

The U.S. Court of Claims held in 1981 that income received by the Disabled American Veterans from other exempt organizations and commercial businesses for the use of its mailing lists constitutes unrelated business taxable income, and does not consitute "royalties" expressly exempted from the tax under section 512(b)(1) (*Disabled American Veterans* v. *U.S.*, 650 F.2d 1128 (1981)). The court found that in renting its donor lists, the DAV operated in a competitive, commercial manner with respect to taxable firms in the direct mail industry; that these rental activities were regularly carried on; and that the rental activities were not substantially related to accomplishment of exempt purposes (apart from the organization's need for or use of funds derived from renting the mailing lists).

EXPLANATION OF THE BILL

In the case of any organization exempt from tax under section 501 which is eligible to receive tax-deductible charitable contributions under section 170, the bill would exclude from the term unrelated trade or business any trade or business of such organization that consists of exchanging, renting, or selling names and addresses of donors to, or members of, such organization. The categories of organizations to which the bill would apply would include (1) tax-exempt charitable, educational, religious, etc. organizations formed in the United States; (2) certain organizations of war veterans and their auxiliary units; and (3) certain domestic fraternal organizations (which are eligible to receive tax-deductible contributions for gifts is used exclusively for charitable, educational, religious, etc., purposes); and (4) certain nonprofit cemetery companies.

EFFECTIVE DATE

The provisions of the bill would apply to taxable years ending after the date of enactment.

REVENUE EFFECT

The provisions of the bill are estimated to reduce budget receipts by $10 million annually.

PRIOR CONGRESSIONAL ACTION

H.R. 4170 (the Deficit Reduction Act of 1984), as passed by the Senate, included a provision (adopted as a floor amendment by Senator Pryor) providing an exemption from the unrelated business income tax for amounts received by certain Federally chartered corporations (named in 36 U.S. Code sec. 1101) for renting or exchanging lists of their donors or members with organizations contributions to which are eligible for charitable deductions. This provision was deleted from the bill in conference.

STATEMENT OF THE AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

The American Society of Association Executives (ASAE), the professional society for over 10,000 executives and other high level management personnel of tax-exempt and nonprofit organizations, supports enactment of H.R. 1773, a bill to exempt certain organizations from the unrelated business income tax (UBIT) on sales of their membership lists. ASAE further supports an amendment to H.R. 1773 which would extend the provisions of the bill to all tax exempt organizations, including business leagues, chambers of commerce and other trade and professional associations which are exempt from taxation under section 501(c)(6) of the Internal Revenue Code.

ASAE supports an exemption from the UBIT for the sale of membership lists for all nonprofit organizations for the following reasons:

1. Nonprofit organizations such as trade and professional organizations are as important, valuable and essential as the types of organizations currently covered in H.R. 1773 and their need to supplement their income from sources other than dues is as great as other types of organizations. It is illogical and unfair to discriminate against them by excluding them from coverage under this bill.

2. Similarly, nonprofit organizations other than charitable organizations such as those covered by H.R. 1773 perform equally valuable services and functions, both for their own members and for the general public and various governmental agencies as do the charitable types of organizations specifically covered in H.R. 1773.

3. The sale of membership lists is not unrelated to the exempt purposes for which nonprofit organizations exist:

Under the Internal Revenue Code, one of the requirements for obtaining tax exempt status is that an applicant organization serve the common interests of its members generally; one way in which an association does this is by informing its members of products, services and ideas that may be of particular interest to them; one way of so informing its members, in turn, is for the association to permit the originators of those products, services or ideas communicate information directly to the members by providing its membership mailing list.

4. The sale of membership lists does not compete with regular for profit commercial enterprise and thus give nonprofits an unfair advantage because these lists are either readily available from public sources, such as telephone or zip code directories; or because the association represents such a precisely defined interest that no commercial organization is willing or interested enough to put together a list of people with that interest for sale to others.

5. Any income derived by an association from the sale of its membership list is likely to be modest, so that any loss to the Treasury is likely to be de minimis and offset by the value of the services the nonprofit will be able to continue to perform as a result of meeting its financial needs, in part through income from the sale of membership lists.

6. Many associations operate on low budgets, so that even modest amounts of income derived from sources other than members dues become important, if not critical, to the continued operation of the organization. Under current administration policy, which is to rely more heavily on the private sector and to rely on volunteers to do work that formerly the government was asked to perform, it is all the more important to give associations as much as possible in remaining solvent and viable so that they can carry out the tasks the government would like to see private and volunteer groups assume.

7. Conceptually and practically, income derived from the sale of an association's mailing list is the same as other possible income derived from rent or royalty payments; yet income from these latter categories is tax exempt and is not considered unrelated business income: applying the principle of treating like things alike, neither should income from the sale of a membership list be considered unrelated business income.

8. The case in the U.S. Claims Court holding that sales of mailing lists constitute unrelated business income (*Disabled American Veterans v. U.S.*, 650 F.2d 1178 (Ct. Cl., 1981)) has in effect been overruled by a recent decision of the U.S. Court of Appeals for the Federal Circuit, which can review decisions of the U.S. Claims Court. This case is *American College of Physicians v. U.S.*,—F.2d—(Fed. Cir., Sept. 17,

1984). Although this case relates to advertising income, the import to revenues from membership lists is manifest.

STATEMENT OF HON. DAVID H. PRYOR, A U.S. SENATOR FROM THE STATE OF ARKANSAS

Mr. Chairman, I commend you for calling this hearing today to examine several tax measures that have been referred to your subcommittee. I have an interest in one of them, H.R. 1773, and my remarks will relate solely to that bill.

Before I speak on this issue, Mr. Chairman, I would first like to commend the efforts of the Gentleman from Tennessee, Mr. Duncan, the Ranking Member of the Subcommittee. He is the sponsor of H.R. 1773, and he's been very instrumental in seeking to have this measure enacted into law.

Mr. Chairman, H.R. 1773 would correct what I sincerely believe to be an incorrect interpretation of our tax code by both the Internal Revenue Service and the U.S. Court of Claims in the area of what constitutes unrelated business income. The rules of the tax code dealing with unrelated business income are there for a good reason—to tax charitable organizations like any other business when they engage in activities that aren't directly related to their charitable work. Also, the rules are designed to prevent a tax-exempt organization from gaining an unfair competitive advantage if they were to sell products that compete against taxable entities.

The problem with the case of mailing lists, Mr. Chairman, is that the Service and the courts have incorrectly interpreted the intent of Congress. H.R. 1773, and S. 2908, a bill I've introduced in the Senate will correct the problem.

The U.S. Court of Claims a few years ago held that income received by the Disabled American Veterans was unrelated business income, and therefore, taxable when the money was received from the rental or sale of the DAV's mailing list. Further, it's my understanding that it's the position of the Treasury Department that even the exchange (or barter) of a list between two tax-exempt organizations would give rise to UBTI. This thwarts what I believe to be the intent of Congress, Mr. Chairman, and I hope we can correct it.

Most non-profit organizations in this country rely on contributions for their existence, and the best way to continue to have steady contributors is through an up-to-date mailing list. In order to maintain a good mailing list, as Mr. Heilman pointed out, you need to exchange with other non-profit organizations. This isn't done for any reason other than to keep the mailing list up-to-date. Therefore, it seems to me that money, or the fair market value, in the case of a pure exchange, should not be UBTI, because the transaction is "directly related to" the activities of the charitable organization. That's what H.R. 1773, any my bill, S. 2908, seek to accomplish.

The bill I introduced would provide an exemption for UBTI for the rental or exchange (but not the sale) of a mailing list by a congressionally-chartered organization with another non-organization. Also, it would provide an exemption for the exchange between two non-profit organizations, deductions to which are tax deductible under Section 170. My bill would still make the sale of a list taxable as UBTI. Therefore, it is narrowly drawn so that organizations like the DAV, the Kidney Fund, and many other charitable organizations can continue to raise money to carry on their important work.

A version of my bill, Mr. Chairman, was adopted by the Senate during our consideration of the Deficit Reduction Act, but was dropped in conference.

I continue to hope that either the legislation I've introduced in the Senate, or the bill before the committee today, H.R. 1773, can be enacted into law next year. I think it is wise from a tax policy standpoint, will lose hardly any money, and more importantly, will conform with what I believe we intended when we enacted the unrelated business income tax rules.

Mr. Chairman, that concludes my statement. Again, I commend you for holding this hearing today. I look forward to working with you on this issue, and once again, I want to thank the Gentleman from Tennessee, Mr. Duncan, for his work in this area. Thank you.

I

98th CONGRESS
1st Session

H. R. 2129

To amend the Internal Revenue Code of 1954 to provide an alternative method of allocation of property taxes for cooperative housing corporations.

IN THE HOUSE OF REPRESENTATIVES

March 16, 1983

Mr. Matsui (for himself, Mr. Stark, and Mr. Thomas of California) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to provide an alternative method of allocation of property taxes for cooperative housing corporations.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) paragraph (3) of section 216(b) of the Internal Revenue Code of 1954 (defining tenant-stockholder's proportionate share) is amended by inserting before the period at the end thereof "; except that, with respect to taxes, if the laws or ordinances of any State (or political subdivision thereof) require a different allocation based upon separate appraisal of some or all of the individual units, the term 'proportionate share' means the amount allocated to those individual units pursuant to such law or ordinance".

(b) The amendment made by subsection (a) shall apply to taxable years beginnning after December 31, 1982.

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SUMMARY AND DESCRIPTION

PRESENT LAW

Taxation of housing cooperatives

Under present law (sec. 216), a tenant-stockholder in a cooperative housing corporation is entitled to deduct amounts paid to the cooperative which represent his or her proportionate share of allowable real estate taxes and interest (e.g., mortgage interest) relating to the land and buildings held by the cooperative. In general, for a cooperative to qualify for this pass-through treatment, (1) each stockholder of the cooperative must be entitled to occupy a house or apartment owned or leased by the cooperative, (2) no stockholder may receive any distribution from the cooperative (other than distributions out of earnings and profits) except on a liquidation of the cooperative, and (3) tenant-stockholders qualifying for pass-through treatment must have paid amounts for their stock which bear a reasonable relationship to the value of that portion of the cooperative's land and building which is attributable to their house or apartment.

To qualify for pass-through treatment, 80 percent or more of the cooperative's gross income must be derived from tenant-stockholders. For purposes for this rule, as well as the rules above, tenant-stockholders are generally limited to individuals. Thus, corporations, trusts, and other similar entities generally do not qualify for pass-through treatment. Limited exceptions to this rule are provided for certain original sellers of property to a cooperative and for banks or other lending institutions which acquire cooperative stock by foreclosure.

In addition to being allowed deductions for rent and taxes, and to the extent a tenant-stockholder uses depreciable property leased from the cooperative in a trade or business or for production of income, the tenant-stockholder is allowed a deduction with respect to the stock the ownership of which entitles him or her to lease the property. This deduction generally cannot exceed that portion of the taxpayer's adjusted basis for the stock which is allocable to the depreciable property.

Allocation of property taxes

Under present law, a tenant-stockholder's proportionate share of interest or property taxes, for deduction purposes, is equivalent to the portion of total cooperative stock which is owned by the tenant-stockholder. This rule applies even if property taxes are imposed on certain tenant-stockholders out of proportion to the value of their coopertative stock (e.g., under certain California property taxes which are assessed based on separate appraisals of individual cooperative units).[1] In such cases, individual tenant-stockholders may be allowed a deduction which is signficantly less than (or greater than) the amount of real estate taxes attributable to their property.

EXPLANATION OF THE BILL

The bill would provide that, if State or local law (or ordinance) requires an allocation of property taxes based on separate appraisal of some or all of the individual units in a housing cooperative, the proportionate share of such taxes for deduction purposes is to be the amount allocated to those units pursuant to such law or ordinance. Thus, property tax deductions would be allocated among the tenant-stockholders according to the actual amount of such taxes attributable to the property of each tenant-stockholder. For example, if an Year 1 all units in a housing cooperative were appraised at the same value for State property tax purposes, but in Year 2 several of the units were given a higher appraisal, then in Year 1 all tenant-stockholders (owning equal shares) would generally be entitled to deduct the same proportionate share of real estate taxes, which in Year 2 the proportionate share allocable to those in reappraised units would be increased, and the proportionate share allocable to those in other units would be decreased, in accordance with the reappraisals.

EFFECTIVE DATE

The bill would be effective retroactively for taxable years beginning after December 31, 1982.

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[1] As a result of Proposition 13, California property tax assessments may generally be increased only upon resale of a unit. Thus, proportionately higher taxes are imposed on units which have been resold.

REVENUE EFFECT

The provisions of the fill are estimated to reduce budget receipts by less than $10 million annually.

PRIOR CONGRESSIONAL ACTION

H.R. 4170 the (Deficit Reduction Act of 1984) as passed by the Senate, included a similar provision (adopted as a floor amendment by Senator Wilson). This provision (together with other amendments which would have affected cooperative housing corporations) was deleted from the bill in conference.

I

98TH CONGRESS
1ST SESSION

H. R. 2686

To amend the Internal Revenue Code of 1954 with respect to the treatment of business development companies.

IN THE HOUSE OF REPRESENTATIVES

APRIL 21, 1983

Mr. GUARINI (for himself, Mr. STARK, and Mr. FRENZEL) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 with respect to the treatment of business development companies.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. BUSINESS DEVELOPMENT COMPANIES.

(a) IN GENERAL.—Subchapter M (relating to regulated investment companies and real estate investment trusts) of chapter 1 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following new part:

"PART IV—PROVISIONS WHICH APPLY TO BUSINESS DEVELOPMENT COMPANIES

"Sec. 860A. Tax Treatment of business development companies.

"SEC. 860A. TAX TREATMENT OF BUSINESS DEVELOPMENT COMPANIES.

"(a) GENERAL RULE.—Except as otherwise provided in this section, the provisions of parts I and III of this subchapter shall apply to a business development company which would be a regulated investment company but for the requirements of section 851(a). When used other than in this section, the term 'regulated investment company' shall be deemed to include a business development company which would be a regulated investment company but for the requirements of section 851(a).

"(b) DEFINITION OF BUSINESS DEVELOPMENT COMPANY.—For purposes of this section, the term 'business development company' means any domestic corporation (other than a personal holding company as defined in section 542 without regard to section 542(c)(8)) which is a business development company within the meaning of section 2(a)(48) (15 U.S.C. 80a-2(a)(48)) of the Investment Company Act of 1940, as amended (15 U.S.C. 80a-1—80b-2)."

(b) CLERICAL AMENDMENT.—The table of parts for subchapter M of chapter 1 of such Code is amended by adding at the end thereof the following new item:

"Part IV. Provisions which apply to business development companies."

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning on or after October 21, 1980.

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SUMMARY AND DESCRIPTION

PRESENT LAW

Overview

Income-producing assets can be owned directly, or can be owned indirectly by means of an equity interest in an intermediary entity. Income generated by property that is owned directly is generally taxed to the owner of the property and therefore is subject to only one level of taxation. Income from property owned indirectly in an intermediary entity is subject to one or two levels of taxation depending on whether the intermediary entity is treated for tax purposes as (1) a separate taxable entity (such as a corporation or an association taxable as a corporation), (2) a complete conduit entity (such as a partnership or S corporation), or (3) as a partial conduit entity (such as a real estate investment trust) under which income is not taxed to the extent it is currently distributed to the entity's owners. A regulated investment company ("RIC") is a partial conduit entity.

RIC's

RICs are domestic corporations that issue shares to investors and invest the proceeds in diversified portfolios of securities. Under the RIC provisions of the Code, a RIC is generally treated as a conduit for tax purposes. This is accomplished by allowing a RIC a deduction for income that is distributed to its shareholders on a current basis. Income that is not distributed on a current basis is taxed at the RIC level as in the case of a normal corporation. The original purpose of the RIC provisions was to permit small investors to obtain the benefits of investment diversification and professional management by making passive investments through a widely held vehicle without subjecting the profits derived from the investment to a second level of taxation.

Requirements for RIC status

A RIC is a domestic corporation that (1) is registered with the Securities and Exchange Commission at all times during the taxable year as a management company or a unit investment trust under the Investment Company Act of 1940, or (2) is a common trust fund or similar fund that is not a "common trust fund" under the Internal Revenue Code and which is excluded by the Investment Company Act from the definition of investment company. Under present law, a business development company within the meaning of section 2(a)(48) of the Investment Company Act does not qualify as a RIC.

Business development companies

Under the Small Business Incentive Act of 1980, certain investment companies providing capital and managerial assistance to small business may elect to be treated as "business development companies" in lieu of registering under the Investment Company Act.

EXPLANATION OF THE BILL

Under the bill, a business development company within the meaning of section 2(a)(48) of the Investment Company Act of 1940, as amended, other than a business development company that is a personal holding company,[1] could qualify as a RIC.

EFFECTIVE DATE

The bill would apply in taxable years beginning on or after October 21, 1980.

REVENUE EFFECT

The provisions of the bill are estimated to decrease fiscal year budget receipts by less than $50 million annually.

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[1] The prohibition against personal holding companies qualifying as RIC's generally was repealed by section 1071 of the Tax Reform Act of 1984 (Public Law 98-369).

I

98TH CONGRESS
1ST SESSION

H. R. 3284

To amend the Internal Revenue Code of 1954 to allow an amortization deduction for bus operating rights based on a 60-month period.

IN THE HOUSE OF REPRESENTATIVES

June 13, 1983

Mr. Jenkins (for himself and Mr. Hance) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to allow an amortization deduction for bus operating rights based on a 60-month period.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DEDUCTION FOR BUS OPERATING AUTHORITY.

(a) General Rule.—For purposes of chapter 1 of the Internal Revenue Code of 1954, in computing the taxable income of a taxpayer who, on November 19, 1982, held one or more bus operating authorities, an amount equal to the aggregate adjusted basis of all bus operating authorities held by the taxpayer on November 19, 1982, or acquired subsequent thereto pursuant to a binding contract in effect on November 19, 1982, shall be allowed as a deduction ratably over a period of 60 months. Such 60-month period shall begin with the later of the month of November 1982 or the month in which acquired, or, if later, at the election of the taxpayer, the first month of the taxpayer's first taxable year beginning after November 19, 1982.

(b) AGGREGATE DEDUCTION NOT TO EXCEED $5,000,000.—

(1) LIMITATION.—

(A) IN GENERAL.—The maximum amount of basis which may be taken into account under this section with respect to all bus operating authorities—

(i) held by a taxpayer on November 19, 1982, or

(ii) acquired by such taxpayer subsequent thereto pursuant to a binding contract in effect on November 19, 1982,

shall not exceed $5,000,000.

(B) ALLOCATION OF LIMITATION AMONG AUTHORITIES.—In the case of a taxpayer with respect to which there is more than 1 bus operating authority described in subparagraph (A), a portion of the $5,000,000 limitation contained in subparagraph (A) shall be allocated to each bus operating authority so described. Such portion shall be an amount which bears the same ratio to $5,000,000 as the adjusted basis of such authority bears to the aggregate adjusted basis of all bus operating authorities so described.

(2) EQUIVALENT BENEFIT WHERE CONSOLIDATED RETURN FILED.—For purposes of paragraph (1), a corporation which is a member of an affiliated group (within the meaning of section 1504) shall be treated as a separate taxpayer.

(c) DEFINITION OF BUS OPERATING AUTHORITY.—For purposes of this section, the term "bus operating authority" means—

(1) a certificate or permit held by a motor common or contract carrier of passengers and issued pursuant to subchapter II of chapter 109 of title 49 of the United States Code, and

(2) a certificate or permit held by a motor carrier authorizing the transportation of passengers, as a common carrier, over regular routes, in intrastate commerce, and issued by the appropriate State agency.

(d) SPECIAL RULES.—

(1) ADJUSTED BASIS.—For purposes of the Internal Revenue Code of 1954, proper adjustments shall be made in the adjusted basis of any bus operating author-

ity for the amounts allowable as a deduction under this section.

(2) CERTAIN STOCK ACQUISITIONS.—

(A) IN GENERAL.—Under regulations prescribed by the Secretary of the Treasury or his delegate, and at the election of the holder of the authority, in any case in which a corporation—

(i) on or before November 19, 1982 (or after such date pursuant to a binding contract in effect on such date), acquired stock in a corporation which held, directly or indirectly, any bus operating authority at the time of such acquisition, and

(ii) would have been able to allocate to the basis of such authority that portion of the acquiring corporation's cost basis in such stock attributable to such authority if the acquiring corporation had received such authority in the liquidation of the acquired corporation immediately following such acquisition and such allocation would have been proper under section 334(b)(2) of such Code,

the holder of the authority may, for purposes of this section, allocate a portion of the basis of the acquiring corporation in the stock of the acquired corporation to the basis of such authority in such manner as the Secretary may prescribe in such regulations. The preceding sentence shall not apply if an election under section 338 of such Code is in effect with respect to the corporation described in clause (i).

(B) TREATMENT OF CERTAIN NONCORPORATE TAXPAYERS.—Under regulations prescribed by the Secretary of the Treasury or his delegate, and at the election of the holder of the authority, in any case in which—

(i) a noncorporate taxpayer or group of noncorporate taxpayers on or before November 19, 1982, acquired in one purchase stock in a corporation which held, directly or indirectly, any bus operating authority at the time of such acquisition, and

(ii) the acquisition referred to in clause (i) would have satisfied the requirements of subparagraph (A) if the stock had been acquired by a corporation,

then, for purposes of subparagraphs (A) and (C), the noncorporate taxpayer or group of noncorporate taxpayers referred to in clause (i) shall be treated as a corporation. The preceding sentence shall apply only if such noncorporate taxpayer (or group of noncorporate taxpayers) on November 19, 1982, held stock constituting control (within the meaning of section 368(c) of the Internal Revenue Code of 1954) of the corporation holding (directly or indirectly) the bus operating authority.

(C) ADJUSTMENT TO BASIS.—Under regulations prescribed by the Secretary of the Treasury or his delegate, proper adjustment shall be made to the basis of the stock or other assets in the manner provided by such regulations to take into account any allocation under subparagraph (A).

(3) SECTION 381 OF THE INTERNAL REVENUE CODE OF 1954 TO APPLY.—For purposes of section 381 of the Internal Revenue Code of 1954, any item described in this section shall be treated as an item described in subsection (c) of such section 381.

(e) EFFECTIVE DATE.—The provisions of this section shall apply to taxable years ending after November 18, 1982.

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SUMMARY AND DESCRIPTION

BACKGROUND

Prior to enactment of the Bus Regulatory Reform Act of 1982, intercity bus operators were required to obtain a bus operating authority before providing service on a particular route. Only a limited number of bus operating authorities were issued. Persons wishing to enter a route often purchased an existing business that already owned an operating authority, and substantial amounts were paid for these operating authorities. Thus, the value of bus operating rights constituted a substantial part of a bus operator's assets and a source of loan collateral.

The 1982 statute, in deregulating intercity buses, allows intercity bus operators to enter on, expand, drop, or change routes, free of Federal barriers. As a result of the relative ease of entry into the intercity bus business, the value of bus operating authorities has diminished significantly.

The owners of bus operating authorities state that their situation is similar to that faced by owners of motor carrier operating authorities after enactment of the Motor Carrier Act of 1980. That statute deregulated the trucking industry; as a result, motor carrier operating authorities lost significant value. In the Economic Recovery Tax Act of 1981, the Congress enacted a provision allowing trucking companies an ordinary deduction ratably over five years for loss in value of motor carrier operating authorities (sec. 266 of the 1981 Act).

PRESENT LAW

A deduction is allowed for any loss incurred in a trade or business during the taxable year, if the loss is not compensated for by insurance or otherwise (Code sec. 165(a)). In general, the amount of the deduction equals the adjusted basis of the property giving rise to the loss (sec. 165(b)). Treasury regulations provide that, to be deductible, a loss must be evidenced by a closed and completed transaction (i.e., must be "realized"), and must be fixed by an identifiable event (Treas. Reg. sec. 1.165-1(b)).

As a general rule, no deduction is allowed for a decline in value of property absent a sale, abandonment, or other disposition. Thus, for a loss to be allowed as a deduction, generally the business must be discontinued or the property must be abandoned (Treas. Reg. sec. 1.165-2). Further, if the property is a capital asset and is sold or exchanged at a loss, the deduction of the resulting capital loss is subject to limitations (secs. 1212, 1211, and 165(f)).

The courts have denied a loss deduction where the value of an operating permit or license decreased as the result of legislation expanding the number of licenses or permits that could be issued. In the view of several courts,[1] the diminution in the value of a license or permit does not constitute an event giving rise to a deductible loss if the license or permit continues to have value as a right to carry on a business.

EXPLANATION OF THE BILL

The bill would allow an ordinary deduction ratably over a 60-month period for taxpayers who held one or more bus operating authorities on November 19, 1982 (the date of enactment of the Bus Regulatory Reform Act of 1982). The amount of the deduction would be the aggregate adjusted bases of all bus operating authorities that were held by the taxpayer on November 19, 1982, or acquired after that date under a contract that was binding on that date.

The maximum amount of basis that could be taken into account with respect to all bus operating authorities held by a taxpayer would be limited to $5 million.

The 60-month period would begin with the later of the month of November, 1982, or, at the taxpayer's election, the first month of the taxpayer's first taxable year beginning after that date. The bill would require that adjustments be made to the bases of authorities to reflect amount allowable as deductions under the bill.

Under regulations to be prescribed by the Treasury, a taxpayer (whether corporate or noncorporate) holding an eligible bus operating authority would be able to elect to allocate to the authority a portion of the cost to the taxpayer of stock in an acquired corporation. The election would be available if the bus operating authority was held (directly or indirectly) by the taxpayer at the time its stock was acquired. In such a case, a portion of the stock basis would be allocated to the authority only if the corporate or noncorporate taxpayer would have been able to make such an allocation had the authority been distributed in a liquidation to which prior law section 334(b)(2) applied. The election would be available only if the stock was acquired on or before November 19, 1982 (or pursuant to a binding contract in effect on such date) and if no election under section 338 is in effect.

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[1] See, *e.g.*, *Consolidated Freight Lines, Inc. v. Comm'r*, 37 B.T.A. 576 (1938), *aff'd* 101 F.2d 813 (9th Cir.), cert. denied, 308 U.S. 562 (1939) (denial of loss deduction attributable to loss of monopoly due to State deregulation of the intrastate motor carrier industry); Monroe W. Beatty, 46 T.C. 835 (1966) (no deduction allowed for diminution in value of liquor license resulting from change in State law limiting grant of such licenses).

EFFECTIVE DATE

The provisions would be effective retroactively for taxable years ending after November 18, 1982.

REVENUE EFFECT

The provisions of the bill are estimated to reduce fiscal year budget receipts by $7 million in 1985, $6 million in 1986, $3 million in 1987, $1 million in 1988, and a negligible amount in 1989.

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98TH CONGRESS
1ST SESSION

H. R. 3388

To provide that the provisions of section 252 of the Economic Recovery Tax Act of 1981 (relating to transfers of property to employees subject to certain restrictions) shall apply to certain transfers occurring during 1973.

IN THE HOUSE OF REPRESENTATIVES

JUNE 22, 1983

Mr. MATSUI (for himself, Mr. THOMAS of California, and Mr. FAZIO) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To provide that the provisions of section 252 of the Economic Recovery Tax Act of 1981 (relating to transfers of property to employees subject to certain restrictions) shall apply to certain transfers occurring during 1973.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That—

(a) IN GENERAL.—Notwithstanding subsection (c) of section 252 of the Economic Recovery Tax Act of 1981, the amendment made by subsection (a) of such section 252 (and the provisions of subsection (b) of such section 252) shall apply to any transfer of stock to any person if—

(1) such transfer occurred in November or December of 1973 and was pursuant to the exercise of an option granted in November or December of 1971,

(2) in December 1973 the corporation granting the option was acquired by another corporation in a transaction qualifying as a reorganization under section 368 of the Internal Revenue Code of 1954,

(3) the fair market value (as of July 1, 1974) of the stock received by such person in the reorganization in exchange for the stock transferred to him pursuant to the exercise of such option was less than 50 percent of the fair market value of the stock so received (as of December 4, 1973),

(4) in 1975 or 1976 such person sold substantially all of the stock received in such reorganization, and

(5) such person makes an election under this section at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe.

(b) LIMITATION ON AMOUNT OF BENEFIT.—Subsection (a) shall not apply to transfers with respect to any employee to the extent that the application of subsection (a) with respect to such employee would (but for this subsection) result in a reduction in liability for income tax with respect to such employee for all taxable years in excess of $100,000 (determined without regard to any interest).

(c) STATUTE OF LIMITATIONS.—

(1) OVERPAYMENTS.—If refund or credit of any overpayment of tax resulting from the application of subsection (a) is prevented on the date of the enactment of this Act (or at any time within 6 months after such date of enactment) by the operation of any law or rule of law, refund or credit of such overpayment (to the extent attributable to the application of subsection (a)) may, nevertheless, be made or allowed if claim therefor is filed before the close of such 6-month period.

(2) DEFICIENCIES.—If the assessment of any deficiency of tax resulting from the application of subsection (a) is prevented on the date of the enactment of this Act (or at any time within 6 months after such date of enactment) by the operation of any law or rule of law, assessment of such deficiency (to the extent attributable to the application of subsection (a)) may, nevertheless, be made within such 6-month period.

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Summary and Description

PRESENT LAW

In general

Under the present law rules relating to transfers of property in connection with the performance of services (sec. 83), an employee generally includes in income the fair market value of transferred property, less any amount paid for the property, when the property first becomes either transferable or not subject to a substantial risk of forfeiture.[1] Thus, if an employee receives property that is both subject to a substantial risk of forfeiture and is not transferable, the employee generally is not taxed until the property becomes either transferable or not subject to a substantial risk of forfeiture. The amount the employee includes in income is equal to the fair market value of the transferred property (as of the time of taxation), less any amount the employee paid for the property.

However, an employee may elect (under sec. 83(b)) to be taxed when the property is received. In that case, the employee includes an amount in income equal to the fair market value of the property when received less any amount paid for the property.

Effect of restrictions

Generally, under section 83, restrictions on property are not taken into account in determining the fair market value of the property. Also, property is considered transferable for purposes of section 83 when the property would not be subject to a substantial risk of forfeiture in the hands of a subsequent transferee.

Prior to enactment of section 252 of the Economic Recovery Tax Act of 1981 [ERTA], the U.S. Tax Court had ruled [2] that stock subject to the "insider trading" rules of section 16(b) of the Securities Exchange Act of 1934 [3] was transferable within the meaning of section 83. Thus, although the taxpayer's profit on a sale of the stock within six months of receipt could be recovered by the corporation, the taxpayer was taxable on the fair market value of the stock when received.

As amended by section 252 of ERTA, section 83 provides that stock subject to the restrictions of section 16(b) of the Securities Exchange Act of 1934 is treated as being subject to a substantial risk of forfeiture and nontransferable for the six-month period following receipt of the stock during which that section applies. Thus, unless the taxpayer elects (under sec. 83(b)) to be taxed when the stock is received, the taxpayer must include in income (and the employer may deduct), at the expiration of the period during which section 16(b) is applicable, the value of the stock at such time, less any amount the taxpayer paid for the stock. A similar rule is provided for stock subject to restrictions on transfer by reason of complying with the "pooling-of-interests" accounting rules of Accounting Series Releases Numbered 130 (10/5/72) 37 FR 20937; 17 CFR 211.135)).

The amendments made to section 83 by section 252 of ERTA apply to taxable years (of the transferee) ending after December 31, 1981.

EXPLANATION OF THE BILL

Under the bill, the rules of section 252 of ERTA would apply if (1) stock was acquired in November or December of 1973 pursuant to options granted in November or December of 1971, (2) the corporation granting the options was acquired in a reorganization during December 1973, and (3) the fair market value of the stock in the acquiring corporation as of July 1, 1974, received in exchange for the stock acquired on exercise of the option, was less than 50 percent of its value on December 4, 1973. This relief under the bill would be allowed only at the election of a shareholder who during 1975 or 1976 sold substantially all the stock so received.

The bill would not apply with respect to a transfer to any employee to the extent that its application would result in a reduction in tax liability (exclfusive of interest) of such employee in excess of $100,000 for all taxable years.

Also, the bill provides that a refund or credit of any overpayment of tax, or an assessment of any deficiency, which is attributable to provisions of the bill, and which otherwise would be barred within six months after the date of enactment, could be made or allowed to the extent attributable to application of provisions of the bill, provided that, in the case of a credit or refund, a claim therefor is filed within such six-month period.

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[1] An employer generally is allowed a business expense deduction, when the employee is taxed, equal to the amount includible in the employee's income (sec. 83(h)).

[2] *Horwith* v. *Comm'r*, 71 T.C. 932 (1979).

[3] 15 U.S.C. sec. 78p(b).

The provisions of the bill could affect the tax liability of an electing person for the year in which stock was sold, as well as the amount of compensation and the year of its inclusion in income. The bill could also affect the amount and timing of any deduction allowable to the employer corporation. The statute of limitations would be kept open for the purpose of making such adjustments.

The intended beneficiaries of the bill are John G. Franzia, Jr., Joseph S. Franzia, and Fred T. Franzia.

EFFECTIVE DATE

The bill would have only retroactive effect, and only to the limited extent provided in the bill and described in the explanation of the provisions of the bill.

REVENUE EFFECT

The provisions of the bill are estimated to have a negligible effect on budget receipts.

PRIOR CONGRESSIONAL ACTION

An identical bill in the 97th Congress (H.R. 4577) passed the House and was favorably reported by the Senate Finance Committee, but was not enacted.

98TH CONGRESS
1ST SESSION

H. R. 3528

To allow a deduction for certain freight forwarder operating authorities.

IN THE HOUSE OF REPRESENTATIVES

JULY 12, 1983

Mrs. KENNELLY introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To allow a deduction for certain freight forwarder operating authorities.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DEDUCTION FOR FREIGHT FORWARDER OPERATING AUTHORITY.

(a) GENERAL RULE.—Section 266(b) of the Economic Recovery Tax Act of 1981 is amended by inserting "or a freight forwarder" after "contract carrier of property".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years ending after June 30, 1980.

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Summary and Description

BACKGROUND

Freight forwarders are required to obtain an operating authority before providing services. Historically, only a limited number of freight forwarder operating authorities were issued. Thus, the value of an operating authority constituted a substantial part of a freight forwarder's assets. Since 1980, however, the Interstate Commerce Commission (the "ICC") has granted operating authorities to freight forwarders without regard to the prior scheme of economic regulation. Nor have freight forwarders been subjected to any significant regulatory entry restrictions. As a result of the relative ease of entry into the freight forwarding business, the value of freight forwarder operating authorities has diminished significantly.

Although the Congress has not acted to deregulate the freight forwarding industry, the owners of freight forwarder operating authorities state that their situation is similar to that faced by owners of motor carrier operating authorities after enactment of the Motor Carrier Act of 1980. That statute deregulated the trucking industry; as a result, motor carrier operating authorities lost significant value. The Economic Recovery Tax Act of 1981 contained a provision that allows trucking companies an ordinary deduction ratably over five years for loss in value of motor carrier operating authorities (sec. 266 of the 1981 Act).

PRESENT LAW

A deduction is allowed for any loss incurred in a trade or business during the taxable year, if the loss is not compensated for by insurance or otherwise (Code sec. 165(a)). In general, the amount of the deduction equals the adjusted basis of the property giving rise to the loss (sec. 165(b)). Treasury regulations provide that, to be deductible, a loss must be evidenced by a closed and completed transaction (i.e., must be "realized"), and must be fixed by an identifiable event (Reg. sec. 1.165-1(b)).

As a general rule, no deduction is allowed for a decline in value of property absent a sale, abandonment, or other disposition. Thus, for a loss to be allowed as a deduction, generally the business must be discontinued or the property must be abandoned (Reg. sec. 1.165-2)). Further, if the property is a capital asset and is sold or exchanged at a loss, the deduction of the resulting capital loss is subject to limitations (secs. 1212, 1211, and 165(f)).

The courts have denied a loss deduction where the value of an operating permit or license decreased as the result of legislation expanding the number of licenses or permits that could be issued. In the value of several courts,[1] the diminution in the value of a license or permit does not constitute an event giving rise to a deductible loss if the license or permit continues to have value as a right to carry on a business.

EXPLANATION OF THE BILL

The bill would expand the scope of section 266 of the 1981 Act to allow an ordinary deduction ratably over a 60-month period for taxpayers who held one or more freight forwarder operating authorities on July 1, 1980 (the date of enactment of the Motor Carrier Act of 1980). The amount of the deduction would be the aggregate adjusted bases of all freight forwarder operating authorities that were held by the taxpayer on July 1, 1980, or acquired after that date under a contract that was binding on that date.

The 60-month period would begin with the later of July 1, 1980, the month in which acquired, or at the taxpayer's election, the first month of the taxpayer's first taxable year beginning after that date. The bill would require that adjustments be made to the bases of authorities to reflect amounts allowable as deductions under the bill.

Under regulations to be prescribed by the Treasury, a corporate taxpayer holding an eligible operating authority would be able to elect to allocate to the authority a portion of the cost to the taxpayer of stock in an acquired corporation (see Treas. Reg. sec. 1.9200-1 for rules relating to motor carrier operating authorities). The election would be available if the operating authority was held (directly or indirectly) by the taxpayer at the time its stock was acquired. In such a case, a portion of the stock basis would be allocated to the authority only if the corporate taxpayer would have been able to make such an allocation had the authority been distributed in a liquidation to which prior-law section 334(b)(2) applied. The election would be available only if the stock was acquired on or before July 1, 1980 (or pursuant to a binding contract in effect on such date).

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[1] See e.g., *Consolidated Freight Lines, Inc. v. Comm'r*, 37 B.T.A. 576 (1938), *Aff'd*. 101 F.2d 813 (9th Cir.), *cert. denied*, 308 U.S. 562 (1939) (denial of loss deduction attributable to loss of monopoly due to State deregulation of the intrastate motor carrier industry); *Monroe W. Beatty*, 46 T.C. 835 (1966) (no deduction allowed for diminution in value of liquor license resulting from change in State law limiting grant of such licenses).

EFFECTIVE DATE

The provisions of the bill would be effective retroactively for taxable years ending after June 30, 1980.

REVENUE EFFECT

The provisions of the bill are estimated to decrease fiscal year budget receipts by $20 million in 1985 and $13 million in 1986.

98TH CONGRESS
1ST SESSION

H. R. 4167

To amend the Internal Revenue Code of 1954 to permit individual retirement accounts, qualified retirement trusts and certain educational organizations to invest in working interests in oil and gas properties without incurring unrelated business taxable income.

IN THE HOUSE OF REPRESENTATIVES

OCTOBER 20, 1983

Mr. JENKINS (for himself, Mr. FOWLER, Mr. GEPHARDT, Mrs. KENNELLY, Mr. MATSUI, Mr. FLIPPO, Mr. ANTHONY, Mr. PHILIP M. CRANE, Mr. ARCHER, Mr. MOORE, Mr. DUNCAN, Mr. PICKLE, Mr. HANCE, Mr. VANDER JAGT, Mr. DORGAN, Mr. CAMPBELL, Mr. KOGOVSEK, Mrs. SCHROEDER, Mr. KRAMER, Mr. SUNDQUIST, Mr. SCHAEFER, Mr. BROWN of Colorado, and Mr. HEFTEL of Hawaii) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to permit individual retirement accounts, qualified retirement trusts and certain educational organizations to invest in working interests in oil and gas properties without incurring unrelated business taxable income.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subsection (b) of section 512 of the Internal Revenue Code of 1954 (relating to modifications to unrelated business taxable income) is amended by inserting after paragraph (15) the following new paragraph:

"(16)(A) In the case of a trust which constitutes a qualified trust under section 401 or which is described in section 408(a) or of an organization described in section 170(b)(1)(A) (ii) or (iv), there shall be excluded all income from a working interest in a domestic oil or gas well, and all deductions and credits directly connected with such income or interest, if such income is allocated to such trust or organization as a limited partner by a limited partnership which at no time during the partnership taxable year in which such allocation is made—

"(i) allocated to the limited partners a lesser share of any item of deduction, loss or credit than their share of income or gain,

"(ii) allocated among the limited partners shares of any item of deduction, loss or credit which differed from the ratio in which they shared income or gain,

"(iii) allocated cash distributions to partners in a different manner than the allocation of income or gain, and

"(iv) had a general partner related to such trust or organization.

"(B) Subparagraph (A) shall not apply in any case, as determined under regulations prescribed by the Secretary, in which multitier partnerships or other arrangements are used for the principal purpose of avoiding the conditions of such subparagraph. Clauses (i), (ii) and (iii) of subparagraph (A) shall not apply to allocations made in accordance with section 704(c)(2) (relating to property contributed to the partnership) on a nondiscriminatory basis as between exempt and nonexempt limited partners.

"(C) For purposes of subparagraph (A)—

"(i) a trust is related to any person that bears the relationship to it described in section 514(c)(9)(B)(iv) (I) and (II); and

"(ii) an organization is related to any person described in section 4946(a)(1)(A) through (G); and

"(iii) a trust or organization is related to—

"(I) any corporation in which it (directly or together with any persons described in clause (i) or (ii)) holds 35 percent or more of the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation, "(II) any partnership in which it (directly or together with any persons described in clause (i) or (ii)) holds 35 percent or more of the capital interest or profits interest or

"(III) a trust or estate in which it (directly or together with any persons described in clause (i) or (ii)) holds 35 percent or more of the beneficial interest.

"For purposes of this subparagraph, in applying section 514(c)(9)(B)(iv) (I) and (II), '35 percent' shall be substituted for '50 percent' in section 4975(e)(2) (E) and (G), and in applying section 4946(a)(1) (A) through (G), 'organization described in section 170(b)(1)(A) (ii) or (iv)' shall be substituted for 'foundation' or 'private foundation' in section 4946 and section 507(d)(2). In applying this subparagraph, a trust or organization which is a limited partner in a partnership shall be treated as owning an interest in the general partner held by any other such trust or organization (or any person related thereto) which is a partner in such partnership.".

(b) Subsection (c) of section 514 of the Internal Revenue Code of 1954 (relating to unrelated debt-financed income) is amended by inserting after paragraph (9) the following new paragraph:

"(10) CERTAIN OIL AND GAS INTERESTS.—For purposes of this section—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'acquisition indebtedness' with respect to a trust which constitutes a qualified trust under section 401 or which is described in section 408(a) or an organization described in section 170(b)(1)(A) (ii) or (iv) does not include indebtedness incurred by a limited partnership described in section 512(b)(16) in acquiring, developing or operating a working interest in a domestic oil or gas well.

"(B) EXCEPTIONS.—The provisions of subparagraph (A) shall not apply with respect to a trust or organization in any case in which—

"(i) the acquisition price of such working interest is not a fixed amount determined as of the date of acquisition;

"(ii) the amount of any such indebtedness or any other amount payable with respect to such indebtedness or the time for making any payment of any such amount, is dependent, in whole or in part, upon any revenue, income, or profits derived by or from such limited partnership;

"(iii) such working interests are at any time after their acquisition leased by the limited partnership to the person selling such properties to the limited partnership or to any person who bears a relationship described in section 267(b) to such person;

"(iv) such working interests are acquired from, or are at any time after the acquisition leased by the limited partnership to, any person who bears a relationship described in section 512(b)(16)(C) to such trust or organization; or

"(v) any person described in clause (iii) or (iv) provides such limited partnership, trust, or organization with nonrecourse financing in connection with such transaction and such debt—

"(I) is subordinate to any other indebtedness on such property, or

"(II) bears interest at a rate which is significantly less than the rate available from any person not described in clause (iii) or (iv) at the time such indebtedness is incurred.

"(C) SPECIAL RULE FOR CERTAIN TRANSFERS.—The provisions of clauses (iii), (iv) and (v) of subparagraph (B) shall not apply to any acquisition, lease, farmout or other transfer of working interests to a person related to the general partner provided the terms of such transfer are consistent with the terms of similar transfers in the geographic area.".

(c) The amendments made by this subsection shall apply to partnership taxable years beginning after December 31, 1982.

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SUMMARY AND DESCRIPTION

PRESENT LAW

In general

Under present law, most organizations that generally are exempt from Federal income taxation under Code section 501(a), including any trust that is part of a tax-qualified pension, profit-sharing, or stock bonus plan described in section 401(a), are subject to tax on any unrelated business taxable income (Secs. 511-514). In addition, a tax is imposed (sec. 408(e)(1)) on the unrelated trade or business income of an individual retirement account or annuity (an IRA). The term unrelated trade or business generally means any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of the activities for which the organization is granted tax exemption.

Present law provides that a tax-exempt organization is treated as being engaged in the same activities as any partnership (whether limited or general) in which the organization invests. Accordingly, if a tax-exempt organization becomes a limited partner in a partnership that owns a working interest in oil and gas properties and the working interest is not substantially related to the organization's exempt function, the income derived from the working interest is subject to the unrelated trade or business tax.

Debt-financed property

Present law also provides that the income of an exempt trust or organization, or an IRA, from debt-financed property that is unrelated to its exempt function is subject to the unrelated business income tax in the proportion in which the property is financed by the debt (sec. 514). Debt-financed property means all property (e.g., rental real estate, tangible personal property, and corporate stock) that is held to produce income and with respect to which indebtedness was incurred to acquire or improve the property or an indebtedness would not have been incurred but for the acquisition or improvement of the property.

A special rule applies under present law to real property acquired by an educational organization described in section 170 or a tax-exempt trust forming part of a tax-qualified pension, etc., plan. Under this rule, debt-financed real property acquired by such an educational organization or exempt trust is not treated as debt-financed property unless all of the following applies:

(1) the acquisition is a fixed amount determined as of the date of acquisition;

(2) the amount of any indebtedness or any other amount payable with respect to such indebtedness, or the time for making any payment with respect to the indebtedness, is not partially or wholly dependent upon any revenue, income, or profits derived from the real property;

(3) the real property is not at any time after acquisition leased by the organization or trust to the seller or to any person related to the seller (within the meaning of sec. 267(b));

(4) the real property is not acquired from, or any time after acquisition, leased to any person that bears a certain relationship to organization or the trust;

(5) the seller or any person related to the seller or the organization or trust (as described in (3) or (4)) does not provide the organization or trust with financing in connection with the acquisition; and

(6) in the case of property acquired by a partnership, either (i) all members of the partnership are tax-exempt organizations with no unrelated trade or business income or (ii) all income, deductions, credits, etc., are allocated to the partners in a qualified allocation (within the meaning of sec. 168(j)(9)).

EXPLANATION OF THE BILL

In general

Under the bill, certain exempt organizations would be permitted to invest in working interests in domestic oil and gas properties without incurring tax for unrelated business income. The organizations that would be eligible under this provision include exempt trusts forming a part of tax-qualified pension plans, IRAs, and tax-exempt educational organizations described in Code sections 170(b)(1)(A)(ii) or 170(b)(1)(A)(iv).

In order to qualify under the special rule of the bill, the trust or organization would have to receive income from the working interest in oil and gas property as a limited partner from a limited partnership. In addition, the limited partnership could not, at any time during the partnership taxable year for which an income allocation is made—

(i) allocate to the limited partners a share of any item of deduction, loss, or credit that is less than the limited partners' share of income or gain;

(ii) allocate among the limited partners any item of deduction, loss, or credit that differs from the ratio in which they share income or gain;

(iii) allocate cash distributions to partners (limited or general) in a manner that differs from the allocation of income or gain.

However, under the bill these restrictions would not apply where the allocations of depreciation, depletion, gain, or loss take account of the variation between the basis of property to the limited partnership and its fair market value at the time of its contribution to the partnership and if the allocations are permissible under Treasury regulations (sec. 704(c)).

For purposes of determining whether an exempt trust or organization is a limited partner or a general partner in a limited partnership, the interests of certain related parties would be taken into account. In addition, an exempt trust or organization that is a limited partner would be treated as owning an interest in any general partner held by any other exempt trust or organization (including related persons) that is a partner in the partnership.

The bill would authorize the Treasury Department to prescribe regulations that would deny the special treatment under the bill in any case in which multi-tier partnerships or other arrangements are used for the principal purpose of avoiding the conditions of the bill.

Debt-financed property

The bill would provide an exception to the rules relating to debt-financed property for working interests in domestic oil and gas properties acquired by tax-qualified pension plans, IRAs, or certain educational organizations, which would be similar to the rules that apply under present law to investments by certain education organizations or tax-qualified pension plans in debt-financed real property.

Under these rules, the exemption would only apply if the acquisition price is a fixed amount and payments are not dependent upon the profits from the property (items 1 and 2 under present law, above). However, the limitations relating to leases between related parties, acquisitions from related parties, and financing from related parties (items 3, 4, and 5, above) would not apply to any acquisition, lease, farmout, or other transfer of a working interest to a person related to the general partner if the terms of the transfer are consistent with the terms of similar transfers in the same geographic area. The restrictions on allocations under present law (item 6 above) would not apply, but special allocation rules would be provided (see In general, above).

EFFECTIVE DATE

The provisions of the bill would apply retroactively for partnership taxable years beginning after 1982.

REVENUE EFFECT

The provisions of the bill are estimated to decrease fiscal year budget receipts by less than $10 million annually.

Association of
Jesuit Colleges & Universities,
Washington, DC, October 4, 1984.

Hon. Dan Rostenkowski,
Chairman, Ways and Means Committee,
House of Representatives, Washington, DC.

Dear Representative Rostenkowski: Attached is a letter from the General Counsel of the Americal Council on Education asking your support for S. 1549 and H.R. 4167. I fully endorse his approach to these bills and, on behalf of the association, ask your support.

Thank you for your attention to this.

Respectfully,

Joseph Kane, *Vice President.*

Hon. DAN ROSTENKOWSKI,
House of Representatives,
Washington, DC.

DEAR REPRESENTATIVE ROSTENKOWSKI: On behalf of the American Council on Education, an association representing over 1,700 colleges, universities, and other organizations in higher education, I am writing to request your support for S. 1549 and H.R. 4167. These bills, which are substantially identical, would amend the Internal Revenue Code of 1954 to permit tax exempt pension funds, colleges, and universities to invest in limited partnerships holding oil and gas working interests without becoming subject to unrelated business income taxes.

This proposed legislation would permit the endowments of institutions of higher education to invest in "working interests" of domestic oil and gas properties without incurring unrelated business taxable income, if such interests are held by the organization as a passive invester in a qualifying limited partnership. In effect, the legislation would permit income from oil and gas production to be treated exactly like income earned by the organization from stocks, bonds, and royalties (including oil and gas royalties). By permitting passive investments in this form, institutional endowments would be better able to diversify their investment portfolios, thereby reducing total portfolio risk without sacrificing total return. The legislation thus would provide an alternative low risk investment opportunity for colleges and universities which have recently had difficulty maintaining an economic rate of return equal to the inflation rate through investment in traditional opportunities.

Besides providing alternative investment opportunities, this legislation would allow colleges and universities to accept and retain donations of oil and gas working interests held as a limited partner without exposure to the unrelated business income tax. It would remove an existing tax barrier to making charitable contributions of this type of property and therefore increase gift opportunities to colleges and universities from the private sector. Education institutions could then retain these very valuable income-generating investments instead of arranging forced sales of interests for which there may be no adequate market.

Not only would this legislation benefit higher education endowment funds, but it would also make additional sources of capital available to the independent oil and gas industry. It is our understanding that this two-fold benefit can be achieved without causing a significant loss of revenue to the Treasury. For these reasons, we hope you will support S. 1549 and H.R. 4167.

Very truly yours,

SHELDON ELLIOT STEINBACH, *General Counsel.*

UNIVERSITY OF ARKANSAS AT LITTLE ROCK,
Little Rock, AR, September 27, 1984.

Congressman DAN ROSTENKOWSKI,
Rayburn House Office Building,
Washington, DC.

DEAR CONGRESSMAN ROSTENKOWSKI: H.R. 4167 has come to the attention of the University of Arkansas at Little Rock. According to our review, it appears that this is very beneficial legislation which would permit university endowments to treat, for tax purposes, income from oil and gas production exactly like income earned from stocks, bonds and royalties. In that regard, it would remove its present tax treatment as unrelated business income and give it the same standing as passive income comparable to interest and dividends earned on stocks, bonds, and royalties. This would be beneficial to permit our friends and donors a tax advantage which would facilitate giving to colleges and universities.

It is my understanding that this legislation will achieve these results for higher education without causing a loss of revenue to the Treasury and at the same time create a new source of capital for domestic independent petroleum companies. Ultimately, I feel that this would be a tremendous boost to higher education.

I personally support this legislation and urge your careful review of its positive effects for higher education and the independent oil industry.

Sincerely,

JIM MAY, *Treasurer.*

STATEMENT OF HON. BILL ARCHER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. Chairman, I appreciate you scheduling hearings on H.R. 4167, a measure which has been cosponsored by seventeen members of the Ways and Means Committee to provide additional investment opportunties for pension funds and colleges and universities and to make available new sources of capital to the domestic energy industry.

Current law permits these institutional investors to benefit from passive investments in oil and gas royalities and net profit interests, but not in working interests which could provide a greater return on investment. This bill would eliminate that prohibition against investing in working interests. One effect of the legislation would be to permit colleges and universities to retain oil and gas working interests which have been donated to them, thereby enabling them to benefit from donations of this nature.

The bill does contain safeguards relating to partnerships allocations, abusive sale-leaseback arrangements, and the use of debt in acquiring shares in a limited partnership. The purpose of these sections is to alleviate concerns that the exemption of income from working interests held by exempt pension funds, colleges and universities from the unrelated business income tax might create the potential for abuse of their tax exempt status.

The bill is also important in terms of impact in providing additional sources of investment capital for the domestic independent oil industry. Our nation's ability to move toward greater energy independence depends to a great extent on the capital available for exploration and development of our domestic hydrocarbon resources.

This legislation will help provide that capital at the same time it provides pension funds and colleges and universities with an investment alternative which can provide a greater return. This translates into increased retirement income for many Americans who depend upon the investments made by their pension plans and into increased income for colleges and universities to use in their educational activities.

I urge the speedy adoption of this legislation to amend the tax code and thereby remove an inequitable impediment to investment in limited partnership holding working interest in oil and gas properties.

BAYLOR UNIVERSITY,
Waco, TX, October 1, 1984.

Hon. ROBERT DOLE,
U.S. Senate,
Washington, DC.

DEAR SENATOR DOLE: I am writing to you to request your support of S.B. 1549, which if passed would amend Sections 512 and 514 of the Internal Revenue Code to permit tax-exempt pension funds and colleges and universities to invest in limited partnerships holding oil and has working interests without becoming subject to unrelated business income tax. Under present law, other passive investments such as stocks, bonds and royalties are not subject ot taxation. This legislation would require the IRS to treat the income from oil and gas investment in a similar fashion.

As you are probably aware, the fund administrators of many colleges and universities are trying to put alumni gifts and bequests to work in more innovative ways so as to raise yields on endowments funds. In doing so, colleges and universities are attempting to offset rising inflation rates and cutbacks of federal aid to their schools. Over the last decade, investments of private financial support to colleges and universities have yielded low returns, while direct investments in oil and gas interests have consistently yielded rates of return in excess of the inflation rate. S.B. 1549 would enable colleges and universities to benefit from such investments without being subject to the unrelated business income tax.

In addition, the proposed legislation would facilitate portfolio diversification into oil and gas investments by pension funds and colleges and universities. Also, the oil and gas industry would benefit by an additional source of capital which would stimulate exploration for new sources of oil and gas.

In view of the substantial benefits which would result if S.B. 1549 is enacted and in the absense of any significant revenue loss to the Treasury from such action, I would sincerely urge your support of this legislation in the Senate. Also, may I request that this letter be made a part of the Record in the House Hearings which are expected to take place on October 3, 1984.

Sincerely,

BASIS H. THOMSON, Jr., *General Counsel.*

Cumberland University,
Lebanon, TN, October 10, 1984.

Congressman Albert Gore, Jr.,
Longworth Building,
Washington, DC.

Dear Al: I am writing to request your support of S. 1549 and H.R. 4167. These Bills would allow tax exempt pension funds, colleges, and universities to invest in limited partnership and holding oil and gas working interests without sustaining income taxes for unrelated business ventures.

In essence, this legislation would provide the same treatment for oil and gas limited partnerships as that currently being used for investment in stocks and bonds. This would allow universities to establish a more diversified investment portfolio and provide incentives for movement of capital into domestic oil and gas productions.

Your support of this legislation will be appreciated.

Sincerely,

Bob Clement, *President.*

Emory University,
Office of the President,
Atlanta, GA, September 28, 1984.

Hon. Ed Jenkins,
House of Representatives,
Washington, DC.

Dear Congressman Jenkins: I am writing to record Emory University's support of H.R. 4167 (S. 1549), the proposed legislation which would permit pension funds, colleges and universities to invest in oil and gas limited partnerships without the unrelated business tax penalty.

As the members of the Select Revenue Subcommittee of Ways and Means consider this matter in early October, I hope they will support this important investment alternative for colleges and universities at a time when the effects of diminishing federal assistance for higher education are being sorely felt on our campuses.

Sincerely,

James T. Laney, *President.*

University of California,
Hastings College of the Law,
San Francisco, CA, October 11, 1984.

Hon. Robert Dole,
Senate Hart Office Building,
Washington, DC.

Dear Senator Dole: This note is to request your support for Senate Bill 1549 which would amend the Internal Revenue Code of 1954 to permit tax exempt pension funds, colleges and universities to invest in limited partnerships holding oil and gas working interests without becoming the subject of unrelated business income taxes.

The above referenced Bill is clearly in the public interest as seen from the standpoint of higher education striving to maintain its independence from government subsidies. Your help will be deeply appreciated.

Sincerely,

Bert S. Prunty, *Dean.*

University of Southern California,
University Park,
Los Angeles, CA, June 22, 1984.

Hon. Dan Rostenkowski,
Rayburn House Office Building,
Washington, DC.

Dear Congressman Rostenkowski: I am writing to request your support of H.R. 4167 which would amend the Internal Revenue Code of 1954 to permit qualified retirement trusts and educational organizations to treat income received from oil and gas working interests in the same manner as income earned from stock and bonds. This legislation would allow colleges and universities to accept and retain gifts of oil and gas working interests without having to arrange forced sales to avoid the Unrelated Business Taxable Income (UBTI). Additionally, by permitting passive investment in this form of asset, college endowments would be better able to diversify their investment portfolios thereby reducing total portfolio risk without sacrificing total returns.

In the treatment of investment income earned by educational organizations, the Internal Revenue Code distinguishes between passive income and unrelated business taxable income. All income not specifically exempt from section 512, for example, income from stocks, bonds and oil royalties, is investment and penalize through taxation active management of unrelated investment and penalize through taxation active management of unrelated businesses. The proposed legislation will not damage the original intent of the UBTI; the statutory language proposed will allow investment only in the form most like passive stock ownership and expressively forbids the exercise of any control over the entity of participation in management decisions with regard to the business of the entity.

The investment objectives of educational organizations such as the University of Southern California have had to adapt to changing economic conditions to deal with inflation and increased funding requirements. Considerable financial support from the private sector and an economic return on the prudent investment of that private financial support, is necessary to maintain the quality of our educational enterprise. Over the last decade, returns from traditional investments—stocks and bonds—have failed to earn an economic rate of return equal to the rate of inflation; the purchasing power of our endowment has declined. Over the same period, direct investment in oil and gas and activities from non-industry sources have proved to be low risk, consistent performing assets generating rates of return in excess of the rate of inflation.

Inasmuch as this legislation will permit educational institutions to diversify their investment portfolios, provide a greater hedge against inflation, increase the gift opportunities to colleges and universities from the private sector and make available additional sources of capital for the domestic oil industry, we urge your consideration and support of this legislation.

Sincerely,

Lyn Hutton, *Treasurer.*

University of South Carolina,
Columbia, SC, October 2, 1984.

Hon. Carroll A. Campbell,
Cannon House Office Building,
Washington, DC.

Dear Carroll: It has been brought to my attention that a bill is before the House of Representatives (H.R. 4167) and the Senate (S. 1549) which amends Sections 512 and 514 of the Internal Revenue Code to permit colleges and universities to invest in limited partnerships holding oil and gas working interests without becoming subject to unrelated business income tax. At the current time, institutions of higher education are subject to unrelated business income tax at corporate rates on income from investments in limited partnerships holding oil and gas working interests. This tax discourages colleges and universities from diversifying their portfolio through investments in the oil and gas industry. It seems reasonable that institutiosn of higher education can receive the same consideration for investment in limited partnerships in the oil and gas industry as they now receive with investments in stocks, bonds and royalties. Furthermore, through investments by colleges and universities, the oil and gas industry will have another source of capital while producing no significant revenue loss for the federal government.

Finally, changes in Sections 512 and 514 of the Internal Revenue Code will allow colleges and universities to be in a more beneficial position when receiving gifts and contributions of this type of property. As you know, the University of South Carolina is in the planning stages of a new complex named for John E. Swearingen, Carolina Alumnus and former Chairman of the Board of Standard Oil of Indiana. The Swearingen Center will be the second largest engineering center in the Southeast and will be built totally with private contributions. Most of the gifts for construction of this center are from Mr. Swearingen's strong friends and associates in the oil industry. Therefore, the University has particular interest in the outcome of this legislation.

Through your support of H.R. 4167 you can provide additional resources for the University and other colleges and universities in the State of South Carolina. If I can provide additional information, please do not hesitate to call upon me.

Sincerely,

JAMES B. HOLDERMAN.

THE UNIVERSITY OF TENNESSEE,
Knoxville, TN, October 5, 1984.

Congressman DAN ROSTENKOWSKI,
Rayburn House Office Building,
Washington, DC.

DEAR CONGRESSMAN ROSTENKOWSKI: House Bill 4167 has come to the attention of the University of Tennessee. According to our review, it appears that this is very beneficial legislation which would permit University endowments to treat, for tax purposes, income for oil and gas production exactly like income earned from stocks, bonds and royalties. In that regard, it would remove its present tax treatment as unrelated business income and give it the same standing as passive income comparable to interest and dividends earned on stocks, bonds, and royalties.

By permitting passive investment in this form, institutional endowments will be better able to diversity their investment portfolios, thereby reducing total portfolio risk without sacrificing total return. Besides providing alternative investment opportunities, this legislation would allow colleges and universities to accept and retain donations of oil and gas working interest held as a limited partner without exposure to the unrelated business income tax.

It is my understanding that this legislation will achieve these results for higher education without causing a loss of revenue to the Treasury and, at the same time, create a new source of capital for domestic independent petroleum companies.

I personally support this legislation and urge your careful review of its positive effects for higher education and the independent oil industry. I respectfully request that this letter be made a part of the record for the House hearings on this Bill.

Sincerely yours,

A. DAVID MARTIN, *Treasurer.*

YALE UNIVERSITY,
New Haven, CT, October 11, 1984.

Chairman FORTNEY H. STARK,
Subcommittee on Select Revenue Measures,
Longworth House Office Building, Washington, DC.

DEAR REPRESENTATIVE STARK: I submit the following comments in support of H.R. 4167 on behalf of Yale University. H.R. 4167 would amend sections 512 and 514 of the Internal Revenue Code to permit educational institutions to treat income derived from oil and and gas interests as passive—hence untaxable—income. This change would enable universities to diversify investments and retain gifts of income producing oil and gas interest.

Yale University is an independent, non-sectarian institution of higher education founded in 1701. We currently educate approximately 5,000 undergraduate students and 5,000 graduate and professional students in eleven programs. Yale educates both men and women in all its academic departments.

We attempt to utilize as productively as possible our financial resources, including Yale's endowment. The endowment, which is made up of capital gifts over many years, is currently worth about $1.1 billion. We drew from that last year about $40 million, or about 10% of the University budget. In 1970, by contrast, the endowment supported 25% of Yale's budget. The reason for this sharp decline is that returns on endowment investments, primarily stock and bond investments, have fallen far short of inflation. We have concluded that we should significantly diversify the portfolio into a number of other investment areas.

Like other nonprofit education institutions, our ability to expand our portfolio—and in fact even to accept gifts which would diversify our portfolio—is limited by the Internal Revenue Code's designation of some forms of alternative investments as "unreleated business taxable interest"—income derived from a business or investment not directly related to the purposes of the tax-exempt institution which is taxed at corporate rates—and "passive income"—specific statutory exemptions for interest and dividends earned on stocks, bonds, and royalties which are therefore not taxed to the institution.

When this legal distinction was created over thirty years ago, oil and gas interests were designated "UBTI," primarily because of the need to ensure that nonprofits were not given unfair investment advantage in these developing investments. Since that time, economic conditions and new investment opportunities have changed, but the legal categories have not. The traditionally passive investment (bond and stocks) no longer maintain the relatively stable economic rate of return whereas direct investments in oil and gas producing properties have turned in to low risk, consistently performing assets. Thus, the UBTI treatment of oil and gas investments no longer protects unfair competition, but instead locks universities and pension plans out of these lucrative, yet truly passive investments.

H.R. 4167 would correct the miscategorization of oil and gas investments, and includes safeguards which will prevent unfair competition by the nonprofit sector. Educational institutions, under this bill, could not take part in the control of the business of producing oil or gas; if an institution should do so, it would be subject to UBTI in the same manner as if it undertook a controlling interest in another type of business effort. In fact, all investments will be restricted to investments in limited partnership interests, and the legislation further prevents abuse of the nonprofit investor by the limited or general partner. Thus, this bill is consistent with the principle which underlies the UBTI concept.

Perhaps more important, H.R. 4167 would permit universities like Yale to receive and retain as a passive investment any gifts of oil and gas interests. Under current law, gifts of oil and gas interests would have to be converted to cash through a forced sale. These interests are relatively illiquid and forced sales typically reduce their immediate value. Furthermore, the university donee has lost permanently the longer-lasting value from income generation. Although there is no way of knowing the full extent to which the existing law has discouraged gifts of these valuable interests to Yale and other universities, there can be no doubt that the few donors possessing these valuable assets would be discouraged from making such a donation.

It is not often that the Congress has the opportunity simultaneously to meet educational needs and encourage capital investment in important energy development interests. H.R. 4167 clearly addresses both of these needs. I urge you to adopt this innovative bill in order to remove outdated and inconsistent restraints on university investments and receipts of gifts.

Sincerely,

JOHN W. BUCKMAN.

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98TH CONGRESS
1ST SESSION

H. R. 4507

To amend the Internal Revenue Code of 1954 to allow the investment credit with respect to taxable businesses conducted by certain religious communities exempt from tax under section 501(d) of such Code.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 18, 1983

Mr. FOLEY (for himself, Mr. RANGEL, Mr. STARK, and Mrs. KENNELLY) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to allow the investment credit with respect to taxable businesses conducted by certain religious communities exempt from tax under section 501(d) of such Code.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. ALLOWANCE OF INVESTMENT CREDIT TO ELIGIBLE SECTION 501(d) ORGANIZATIONS.

(a) IN GENERAL.—Section 48 of the Internal Revenue Code of 1954 (relating to definitions and special rules) is amended by redesignating subsection (r) as subsection (s) and by inserting after subsection (q) the following new subsection:

"(r) CERTAIN SECTION 501(d) ORGANIZATIONS.—

"(1) IN GENERAL.—In the case of an eligible section 501(d) organization—

"(A) any business engaged in by such organization for the common benefit of its members and the taxable income from which is included in the gross income of its members shall be treated as an unrelated business for purposes of paragraph (4) of subsection (a),

"(B) the qualified investment for each taxable year with respect to such business shall be apportioned pro rata among such members in the same manner as the taxable income of such organization, and

"(C) any individual to whom any investment has been apportioned under subparagraph (B) shall be treated for purposes of this subpart (other than section 47) as the taxpayer with respect to such investment, and such investment shall not (by reason of such apportionment) lose its character as an investment in new section 38 property or used section 38 property, as the case may be.

"(2) LIMITATION ON USED SECTION 38 PROPERTY APPLIED AT ORGANIZATION LEVEL.—The limitation under subparagraph (A) of subsection (c)(2) shall apply with respect to the section 501(d) organization.

"(3) RECAPTURE.—For purposes of applying section 47 to any property for which credit was allowed under section 38 by reason of this subsection—

"(A) the section 501(d) organization shall be treated as the taxpayer to which the credit under section 38 was allowed,

"(B) the amount of such credit allowed with respect to the property shall be treated as the amount which would have been allowed to the section 501(d) organization were such credit allowable to such organization,

"(C) subparagraph (D) of section 47(a)(5) shall not apply, and

"(D) the amount of the increase in tax under section 47 for any taxable year with respect to property to which this subsection applies shall be allocated pro rata among the members of such organization in the same manner as such organization's taxable income for such year is allocated among such members.

"(4) NO INVESTMENT CREDIT ALLOWED TO MEMBER IF MEMBER CLAIMS OTHER INVESTMENT CREDIT.—No credit shall be allowed to an individual by reason of this subsection if such individual claims a credit under section 38 without regard to this subsection. The amount of the credit not allowed by reason of the preceding sentence shall not be allowed to any other person.

"(5) ELIGIBLE SECTION 501(d) ORGANIZATION.—For purposes of this subsection, the term 'eligible section 501(d) organization' means any organization—

"(A) which elects to be treated as an organization described in section 501(d) and which is exempt from tax under section 501(a), and

"(B) which, as of the close of the taxable year—

"(i) has been in existence for more than 5 years, or

"(ii) more than one-half the members of which have been members for more than 5 years of any organization described in subparagraph (A) or any religious community which is part of an organization described in section 501(c)(3) and exempt from tax under section 501(a)."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to periods after December 31, 1978 (under rules similar to the rules of section 48(m) of the Internal Revenue Code of 1954), in taxable years ending after such date.

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SUMMARY AND DESCRIPTION

PRESENT LAW

Present law provides an income tax exemption for a religious or apostolic association or corporation if (1) it has a common treasury or community treasury, even if it engages in business for the common benefit of the members, and (2) its members include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the organization's taxable income for such year (sec. 501(d)). Any amount so included in the gross income of a member is treated as a dividend received. Thus, members of section 501(d) organizations file individual tax returns and pay income tax on their pro rata shares of organization income.

While a nonprofit religious organization may qualify for tax-exempt status under section 501(c)(3) if it meets the requirements of that section, exemption under that provision is not available if the organization is operated for the primary purpose of conducting an unrelated trade or business or otherwise is not operated exclusively for exempt purposes, or if any part of the organization's net earnings inures to the benefit of a private individual. Accordingly, a communal religious organization which is organized and operated for the primary purpose of carrying on an unrelated trade or business cannot qualify for exemption under section 501(c)(3), but could seek to qualify for exemption under section 501(d) if its members included the organization's taxable income on their returns (see Treas. Reg. sec. 1.501(c)(3)-1(e)(1); GCM 38827, March 23, 1982)).

The Code allows an investment tax credit for certain acquisitions of depreciable property (sec. 38(a)). In the case of such property used by a tax-exempt organization, however, the credit is not allowed unless the property is used in an unrelated trade or business the income of which is subject to tax under section 511 (sec. 48(a)(4)). The Ninth Circuit has ruled that since section 501(d) organizations are not subject to the section 511 tax on unrelated business taxable income, neither the organization nor its members on their tax returns can claim the investment tax credit for depreciable property acquired by the organization (*Kleinsasser* v. *U.S.*, 707 F.2d 1024 (9th Cir. 1983)).

EXPLANATION OF THE BILL

The bill would provide that, for purposes only of the investment credit rules in section 48(a)(4), any business which is conducted by an eligible section 501(d) organization for the common benefit of its members and the taxable income from which is included in the gross income of its members is to be treated as an unrelated business. Accordingly, the acquisition of depreciable property by an eligible section 501(d) organization for use in such a business would give rise to an investment tax credit to the same extent as if the property had been acquired by a section 501(c)(3) organization for use in an unrelated business.

Under the bill, the amount of such qualified investment by a section 501(d) organization would be apportioned pro rata among its members in the same manner as its taxable income is allocated. The bill would not allow any credit for such investment to a member who claimed any other type of investment credit, and would prohibit the reallocation of any such disallowed credit to other community members. The used-property credit limitation and credit recapture rules would apply at the organization level.

The provisions of the bill would apply to any organization which elects to be treated as an organization described in section 501(d) and which is exempt from tax under section 501(a), provided that as of the close of the taxable year either (a) the organization has been in existence for more than five years, or (b) more than one-half its members have been members for more than five years of any tax-exempt section 501(d) organization or of any religious community which is part of a tax-exempt organization described in section 501(c)(3).

EFFECTIVE DATE

The provisions of the bill would apply retroactively to periods after 1978 (under rules similar to those in Code sec. 48(m)).

REVENUE EFFECT

The provisions of the bill are estimated to decrease fiscal year budget receipts by less than $5 million annually.

STATEMENT OF HON. JERRY BROWN, FORMER GOVERNOR, STATE OF CALIFORNIA

As governor of California, I observed the excellent example set for all of us by the religious communities such as the Trappists. By their commitment to their religious life they affirm the practicality of the monastery in the twentieth century based on the religious doctrines that date at least to the Middle Ages. Not only do they set a fine religious example but they set an impressive example in their commitment to support themselves through activities at the community.

Almost fifty years ago Congress decided it was fair to allow a religious community to be tax exempt if its members report their pro rata rate share of the income. Somehow when the investment credit was adopted, Congress overlooked providing for the passthrough of this credit for the members of electing communities. It seems like the appropriate response is to pass H.R. 4507 so that the passthrough will be available. Therefore, I urge action on this bill at the earliest possible time. The failure to allow the investment credit to the members of communities like the Trappists and Hutterites is an unjustified discrimination.

STATEMENT OF HON. THOMAS S. FOLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Mr. Chairman, I would like to thank you and the Subcommittee on Select Revenue for this opportunity to testify on behalf of H.R. 4507, legislation which I introduced on November 18, 1983, H.R. 4507 would amend the Internal Revenue Code of 1954 to allow the investment credit with respect to taxable businesses conducted by certain religious communities exempt from tax under section 501(d) of such Code. As you know, this legislation is cosponsored by the distinguished Chairman of this Subcommittee; by Representatives Barbara Kennelly, and Richard T. Schulze, also members of this Subcommittee; by Representative Charles B. Rangel, the distinguished Chairman of the Ways and Means Subcommittee on Oversight; and by Representative Edward P. Boland.

H.R. 4507 addresses a statutory inequity in the Internal Revenue Code relating to members of certain religious communities organized under section 501(d). Section 501(d) of the Code allows religious communities to engage in the operation of a community business which is exempt from taxation on the condition that members of such communities report as personal income a pro rata share of the organization's income. The pro rata share is then taxed at the member level as a dividend received from the community. In short, the religious community does not pay tax but its members do. Thus, a section 501(d) organization is more nearly comparable to organizations which pass through the tax burden on income (I.E., trusts, partnerships, and subchapter S corporations) than to other section 501 organizations.

Because the Code stipulates that religious communities organized under section 501(d) do not pay tax on income from exempt activities, the Internal Revenue Service has taken the position that members of such communities cannot receive the investment tax credit for business machinery purchased by the community. This interpretation, although consistent with existing provisions in the Internal Revenue Code. discriminates against members of section 501(d) organizations as compared with partners in a partnership or shareholders in a subchapter S corporation. Members of such organizations pay more tax because they are denied the investment credit available to partnerships and subchapter S corporations. In *Kleinsasser* v. *United States* (1982), the Ninth Circuit Court recognized the obvious problem but, because the Internal Revenue Code does not directly address the issue, denied the investment credit to section 501(d) organization members. The Court's opinion, however, stated that the failure to provide for the investment tax credit appeared to be a legislative oversight and urged religious communities operating under section 501(d) to petition the Congress for relief.

H.R. 4507 clarifies the Internal Revenue Code by extending the investment credit to section 501(d) organizations meeting the demonstrated stability requirements defined in the bill's eligibility provision. Paralleling the manner in which a religious community's business income is taxed under section 501(d), the legislation apportions pro rata among members the qualified investment and credit for each taxable year. The pro rata appointment of the investment credit ensures that the fractional amount of credit will be the same on each community member's tax return, thereby simplifying the filing and processing of those returns. In addition, the bill does not allow credit for investment in eligible depreciable property to members who claim another type of investment credit and prohibits the reallocation of any disallowed property credit to other community members.

At present there are only approximately 75 section 501(d) organizations nationwide. Any revenue loss resulting from extension of the investment credit to eligible religious communities, therefore, would be extremely minute.

Mr. Chairman, I look forward to working with you and other Members of the Ways and Means Committee, as well as the Members of the full House of Representatives, to enact this important clarification of the Internal Revenue Code.

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98TH CONGRESS
2D SESSION

H. R. 4779

To amend the Internal Revenue Code of 1954 to provide that the windfall profit tax shall not apply to an amount of crude oil equal to the amount of residual fuel oil used in enhanced recovery processes.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 7, 1984

Mr. THOMAS of California (for himself, Mr. LAGOMARSINO, Mr. PASHAYAN, and Mr. MCCANDLESS) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to provide that the windfall profit tax shall not apply to an amount of crude oil equal to the amount of residual fuel oil used in enhanced recovery processes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subsection (b) of section 4991 of the Internal Revenue Code of 1954 (defining exempt oil) is amended by striking out "and" at the end of paragraph (5), by striking out the period at the end of paragraph (6) and inserting in lieu thereof ", and", and by adding at the end thereof the following new paragraph:

"(7) any exempt production oil."

(b) Section 4994 of such Code (relating to definitions and special rules relating to exemptions) is amended by adding at the end thereof the following new subsection:

"(h) EXEMPT PRODUCTION OIL.—For purposes of section 4991(b)—

"(1) IN GENERAL.—The term 'exempt production oil' means, with respect to any person, the number of barrels of domestic crude oil—

"(A) of which such person is the producer,

"(B) which is removed from a property during the calendar quarter,

"(C) which would (but for section 4991(b)(7)) be taxable crude oil,

"(D) which is attributable to such person's operating mineral interest (as defined in section 614(d)) in the property, and

"(E) which is exchanged solely for an equal number of barrels of residual fuel oil used by such person with respect to such property during such quarter or next succeeding quarter in enhanced recovery processes.

"(2) DETERMINATION OF FUEL OIL USED.—

"(A) IN GENERAL.—For purposes of paragraph (1), a person shall be treated as using residual fuel oil with respect to any property during a calendar quarter in an amount which bears the same ratio to—

"(i) the aggregate residual fuel oil used during such quarter in enhanced recovery processes with respect to crude oil from such property, as

"(ii)(I) the amount of such person's share for such quarter of the production of crude oil from such property bears to

"(II) the amount of such production.

"(B) APPLICATION TO NONOPERATING INTERESTS.—

"(i) RESIDUAL FUEL OIL NOT TREATED AS USED BY NONOPERATING INTERESTS.—Subparagraph (A) shall apply only to shares of production which are attributable to operating mineral interests (as defined in section 614(d)).

"(ii) UNALLOCATED RESIDUAL FUEL OIL TREATED AS USED BY OPERATING INTERESTS.—For purposes of subparagraph (A)(ii)(II), the amount of production of crude oil from a property for a quarter shall be reduced by the amount of such production which is not attributable to operating mineral interests (as so defined).

"(3) ALLOCATION OF EXEMPT PRODUCTION OIL AMONG TIERS.—Under regulations prescribed by the Secretary, exempt production oil shall be allocated—

"(A)(i) in any case where the crude oil produced from a property falls within 1 tier, to such tier of oil, or

"(ii) in any case where the crude oil produced from a property falls within more than 1 tier, among the tiers in proportion to the production from such property for such quarter of domestic crude oil in each such tier, and

"(B) within any tier of taxable crude oil, on the basis of the removal prices for such person's domestic crude oil (produced from such property) in such tier removed during such quarter, beginning with the highest of such prices.

For purposes of this paragraph, crude oil which is not taxable crude oil (without regard to this section) shall be treated as a tier of oil and newly discovered oil shall be treated as a separate tier of oil and not included in tier 3 oil.

"(4) RESIDUAL FUEL OIL DEFINED.—For purposes of this subsection, the term 'residual fuel oil' means—

"(A) any fuel oil commonly known as—

"(i) No. 4, No. 5, or No. 6 fuel oil,

"(ii) Bunker C, or

"(iii) Navy Special Fuel Oil, and

"(B) any fuel oil not described in subparagraph (A) which has a 50 percent boiling point over 700 degrees Fahrenheit in the ASTM D-86 standard distillation test.

"(5) ENHANCED RECOVERY PROCESS.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'enhanced recovery process' means any process—

"(i) for increasing the ultimate total recovery of oil from a reservoir which is designed to modify any property of any fluid in the reservoir or the reservoir rock, or

"(ii) for displacing or controlling the flow rate or flow pattern in the reservoir.

"(B) EXCLUSION OF PROCESSES APPLIED SOLELY TO AID LIFTING.—Such term does not include any process the sole purpose of which is to aid in the lifting of fluids in the well bore."

(c) Section 611 of such Code (relating to the allowance of a deduction for depletion) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) EXEMPT PRODUCTION OIL.—No deduction for depletion shall be allowed under this subchapter with respect to crude oil which is exempt from the tax imposed by section 4896 solely by reason of section 4991(b)(7)."

(d) The amendments made by this Act shall apply to residual fuel oil used, and crude oil removed, after the date of the enactment of this Act.

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SUMMARY AND DESCRIPTION

PRESENT LAW

Present law imposes an excise tax (a windfall profit tax on domestically produced crude oil when the oil is removed from the premises on which it was produced (secs. 4986 et seq.). If crude oil is used before the tax is imposed, then the windfall profit tax is imposed on the use. The Joint Statement of Managers for the Windfall Profit Tax Act indicated that because of differences in the definition of the word property, a producer could have a single, undivided piece of land which constitutes many DOE "properties," even though they are contiguous and not even divided by a public road. The statement stated that in such a case, "powerhouse" fuel produced on one section of a single undivided piece of land is not taxable if it is used on another section of the same piece of land as powerhouse fuel and never leaves the piece of land on which it is produced. The windfall profit tax treatment of such oil was to have no implication for its treatment for various income tax purposes.[1] Thus, present law does not impose the windfall profit tax on crude oil used as powerhouse fuel on the property from which it was removed. However, present law does impose the windfall profit tax in a case in which the owner of a property delivers its product to a refinery which removes the light hyrocarbons from that oil and returns the residual to the producer for use as fuel in powering production equipment on the property.

EXPLANATION OF THE BILL

The bill would provide a statutory exemption for certain production which is used to power production equipment on the producer's property. This exempt production oil would be so much of the producer's crude oil as is (1) removed from the property during the calendar quarter, (2) would otherwise be taxable, (3) is attributable to the producer's operating mineral interests, and (4) is exchanged solely for an equal number of barrels of residual fuel oil used by the producer with respect to the property during that or the succeeding quarter in enhanced recovery processes.

A person's share of residual fuel oil used on the property would be the same as that person's interest in production from the property for the quarter period. The bill would authorize the Treasury to prescribe regulations allocating a person's exempt production among and within the various tiers of taxable crude oil provided by under the windfall profit tax.

For purposes of this exemption, an enhanced recovery process would be any process for increasing the ultimate total recovery of oil from a reservoir by modifying any property of any fluid in the reservoir or any process for displacing or controlling the flow rate or pattern in the reservoir. Enhanced recovery processes would not include any process the sole purpose of which is to aid in lifting fluids to the well bore. Residual fuel oil would be defined to include No. 4, No. 5, or No. 6 fuel oil, Bunker C oil, Navy special fuel oil, or any other fuel which has a 50 percent boiling point in excess of 700 degrees Fahrenheit in the ASTM D-86 standard distillation test. The exemption in the bill would not apply to any oil attributable to nonoperating mineral interests such as royalty interests.

The bill would also provide that no depletion is available with respect to oil exempt from the windfall profit tax under the production oil exception.

EFFECTIVE DATE

The provisions of the bill would apply to residual fuel used and crude oil removed after the date of enactment.

REVENUE EFFECT

The provisions of the bill are estimated to have a negligible effect on budget receipts.

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[1] H.R. Rpt. No. 96-817, 96th Cong., 2d Sess. 105-106.

I

98TH CONGRESS
2D SESSION

H. R. 5022

To amend the Internal Revenue Code of 1954 to provide that percentage depletion shall not be allowable for lease bonuses, advance royalties, or similar payments with respect to oil and gas properties.

IN THE HOUSE OF REPRESENTATIVES

MARCH 5, 1984

Mr. STARK introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to provide that percentage depletion shall not be allowable for lease bonuses, advance royalties, or similar payments with respect to oil and gas properties.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subsection (d) of section 613A of the Internal Revenue Code of 1954 (relating to limitations on application of subsection (c)) is amended by adding at the end thereof the following new paragraph:

"(5) PERCENTAGE DEPLETION NOT ALLOWED FOR LEASE BONUSES, ETC.—In the case of any oil or gas property to which subsection (c) applies, for purposes of section 613, the term 'gross income from the property' shall not include any lease bonus, advance royalty, or other amount payable without regard to production from the property."

(b) The amendment made by subsection (a) shall take effect on January 1, 1984.

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SUMMARY AND DESCRIPTION

PRESENT LAW

In the Tax Reduction Act of 1975, the Congress repealed the percentage depletion allowance for oil and gas production except with respect to limited quantities produced by independent producers and royalty owners. Effective January 1, 1984, the rate for percentage depletion on oil and gas produced by independents and royalty owners declined to a permanent level of 15 percent and the depletable quantity of oil and gas was limited to 1,000 barrels per day.

Following the 1975 depletion amendments, disagreement arose over the treatment of amounts paid in advance of production (i.e., bonuses and advance royalties). The Internal Revenue Service argued that the 1975 Act tied percentage depletion to actual production and, therefore, denied percentage depletion with respect to bonus and advance royalties paid prior to the start of production. In January, 1984, the Supreme Court held that a bonus or advance royalty paid to a lessor in a year in which no oil or gas is produced is subject to percentage depletion notwithstanding the 1,000 barrel per day limitation (*Comm'r* v. *Engle*, 104 S.Ct. 597 (1984)). The Court left open the possibility that the Treasury Department could promulgate regulations giving effect to the limitation by limiting the period in which depletion may be claimed. The extent of this possible regulatory authority is unclear.

EXPLANATION OF THE BILL

The bill would provide that no percentage depletion may be claimed with respect to gross income from any lease bonus, advance royalty, or other amount payable without regard to actual production from the property.

EFFECTIVE DATE

This amendment would take effect on January 1, 1984.

REVENUE EFFECT

The provisions of the bill are estimated to increase fiscal year budget receipts by $336 million in 1985, $253 million in 1986, $249 million in 1987, $234 million in 1988, and $215 million in 1989.

I

98th CONGRESS
2d Session

H. R. 5199

To amend the Internal Revenue Code of 1954 to clarify that the farm syndicate rules of section 278(b) apply in the case of inedible fruits and nuts.

IN THE HOUSE OF REPRESENTATIVES

March 20, 1984

Mr. Stark introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to clarify that the farm syndicate rules of section 278(b) apply in the case of inedible fruits and nuts.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subsection (b) of section 278 of the Internal Revenue Code of 1954 (relating to certain capital expenditures of farming syndicates) is amended—

(1) by striking out "a grove, orchard, or vineyard in which fruit or nuts are grown" and inserting in lieu thereof "a grove, orchard, vineyard, or other tract of trees, bushes, shrubs, or vines in which fruit or nuts (whether or not edible) are grown", and

(2) by striking out "grove, orchard, or vineyard" in paragraphs (2) and (3) and inserting in lieu thereof "grove, orchard, vineyard, or other tract".

(b) Subsection (c) of section 278 of such Code is amended by striking out "grove, orchard, or vineyard" and inserting in lieu thereof "grove, orchard, vineyard, or other tract".

(c) The amendments made by this section shall apply to amounts paid or incurred after March 20, 1984, in taxable years ending after such date.

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SUMMARY AND DESCRIPTION

PRESENT LAW

Under present law, farming syndicates must capitalize the costs of planting, cultivating, maintaining, and developing certain groves, orchards, and vineyards in which fruit or nuts are grown, if the costs are incurred before the grove, orchard, or vineyard bears a crop or yield in commercial quantities (sec. 278(b)). The costs that are required to be capitalized include any amount which would be allowable as a deduction but for this provision. An exception to this capitalization rule is provided for amounts otherwise allowable as deductions which are attributable to a grove, orchard, or vineyard which is replanted after having been lost or damaged while in the hands of the taxpayer by reason of freezing temperatures, disease, drought, pests, or casualty.

A farming syndicate is defined generally as including (1) a partnership or other enterprise (other than a corporation which is not an S corporation) engaged in the trade or business of farming if, at any time, interests in the partnership or other enterprise have been offered for sale in an offering required to be registered with a Federal or State agaency having authority to regulate the offering of securities for sale, or (2) a partnership or other enterprise (other than a corporation which is not an S corporation) engaged in the trade or business of farming if more than 35 percent of the losses during any period are allocable to limited partners or limited entrepreneurs (sec. 464(c)).

Under proposed regulations, for purposes of section 278(b), a grove, orchard, or vineyard in which fruit or nuts are grown includes any group of trees, bushes, shrubs, or vines which produce a crop or yield of fruit or nuts. A fruit is defined as a fertilized and developed ovary of a plant, including the seeds, or, in the case of a plant that does not bear seeds, the fertile structure of the plant, and a nut is defined as a hard-shelled fruit. For example, fruits or nuts include apples, avocados, coffee beans, grapes, jojoba beans or seeds, pecans, pistachios, and walnuts (Treas. Prop. Regs. sec. 1.278-2(a)(2)).

Some taxpayers have argued that because the jojoba is the seed of a fruit, and inedible, the capitalization requirements for farming syndicates under section 278(b) do not apply to farming syndicates investing in jojoba beans.

EXPLANATION OF THE BILL

Under the bill, farming syndicates would be required to capitalize the costs of planting, cultivating, maintaining, and developing a grove, orchard, vineyard, or other tract of trees, bushes, shrubs, or vines in which fruit or nuts (whether or not edible) are grown. Thus, the bill would provide that the rules under section 278(b) relating to certain capital expenditures of farming syndicates apply to farming syndicates investing in inedible fruits or nuts such as jojoba beans.

EFFECTIVE DATE

The bill would apply to amounts paid or incurred after March 20, 1984, in taxable years ending after such date.

REVENUE EFFECT

The provisions of the bill are estimated to increase fiscal year budget receipts by $11 million in 1985, $10 million in 1986, $10 million in 1987, $11 million in 1988, and $11 million in 1989.